

# Internal Revenue bulletin

Bulletin No. 1999-10  
March 8, 1999

## HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

### INCOME TAX

#### **Rev. Rul. 99-10, page 10.**

**Insurance companies; interest rate tables.** Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 1998 and 1999. Rev. Rul. 92-19 supplemented in part.

#### **Rev. Rul. 99-11, page 18.**

**Determination of issue price in the case of certain debt instruments issued for property.** This ruling provides various prescribed rates for federal income tax purposes for March 1999.

#### **Rev. Rul. 99-13, page 4.**

**Election in respect of losses attributable to a disaster.** This ruling lists the areas declared by the President to qualify as major disaster areas during 1998 under the Disaster Relief and Emergency Assistance Act.

#### **T.D. 8808, page 21.**

#### **REG-106564-98, page 53.**

Temporary, proposed, and final regulations under sections 6221 through 6233 of the Code relate to the unified partnership audit procedure added to the Code by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). A public hearing is scheduled for April 14, 1999.

#### **T.D. 8811, page 19.**

#### **REG-121806-97, page 46.**

Temporary, proposed, and final regulations under section 6103 of the Code relate to additions to, and deletions from, the list of items of information disclosed to the Bureau of the Census for use in certain statistical programs.

### EXEMPT ORGANIZATIONS

#### **Announcement 99-19, page 63.**

A list is given of organizations now classified as private foundations.

### ADMINISTRATIVE

#### **Notice 99-13, page 26.**

The "differential earnings rate" under section 809 of the Code is tentatively determined for 1998 together with the "recomputed differential rate" for 1997.

#### **REG-209619-93, page 28.**

Proposed regulations under section 468 of the Code relate to the designation of the person required to report the income earned on qualified settlement funds and certain other funds, trusts, and escrow accounts, and other related rules. A public hearing is scheduled for May 12, 1999.

#### **REG-116826-97, page 40.**

Proposed regulations under section 221 of the Code relate to the deduction for interest paid on qualified education loans. The service will publish the time and date of the public hearing in an announcement in the Federal Register.

#### **REG-104924-98, page 47.**

Proposed regulations under section 475 of the Code are set forth for dealers in commodities and traders in securities or commodities regarding the election to use the mark-to-market method of accounting for their businesses. A public hearing is scheduled for June 3, 1999.

#### **REG-110524-98, page 55.**

Proposed amendments to the regulations under section 453 of the Code relate to the taxation of capital gains on installment sales of depreciable real property.

#### **REG-113744-98, page 59.**

Proposed regulations under section 1296 of the Code relate to the new mark-to-market election for stock of a passive foreign investment company (PFIC).

Finding Lists begin on page 66.



Department of the Treasury  
Internal Revenue Service

# Mission of the Service

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities

and by applying the tax law with integrity and fairness to all.

# Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and proce-

dures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

## **Part I.—1986 Code.**

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

## **Part II.—Treaties and Tax Legislation.**

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

## **Part III.—Administrative, Procedural, and Miscellaneous.**

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

## **Part IV.—Items of General Interest.**

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semiannual period, respectively.

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# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99-11, page 18.

## Section 165.—Losses

26 CFR 1.165-11: Election in respect of losses attributable to a disaster.

**Insurance companies; interest rate tables.** Prevailing state assumed interest rates are provided for the determination of the reserves under section 807 of the Code for contracts issued in 1998 and 1999. Rev. Rul. 92-19 supplemented in part.

## Rev. Rul. 99-13

Under § 165(i) of the Internal Revenue Code, if a taxpayer suffers a loss attributable to a disaster occurring in an area subsequently determined by the President of

the United States to warrant assistance by the Federal Government under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. §§ 5121-5204c (1988 & Supp. V 1993) (the Act), the taxpayer may elect to claim a deduction for that loss on the taxpayer's federal income tax return for the taxable year immediately preceding the taxable year in which the disaster occurred.

Section 1.165-11(e) of the Income Tax Regulations provides that the election to deduct a disaster loss for the preceding year must be made by filing a return, an amended return, or a claim for refund on or before the later of (1) the due date of the taxpayer's income tax return (determined without regard to any extension of time to file the return) for the taxable year in which the disaster actually occurred, or (2) the due date of the taxpayer's income tax return (determined with regard to any extension of time to file the return) for the taxable year immediately preceding the

taxable year in which the disaster actually occurred.

The provisions of § 165(i) apply only to losses that are otherwise deductible under § 165(a). An individual taxpayer may deduct losses if they are incurred in a trade or business, if they are incurred in a transaction entered into for profit, or if they are casualty losses under § 165(c)(3).

The President has determined that during 1998 the areas listed below have been adversely affected by disasters of sufficient severity and magnitude to warrant assistance by the Federal Government under the Act.

## DRAFTING INFORMATION

The principal author of this revenue ruling is Timothy Sheppard of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Sheppard on (202) 622-4960 (not a toll-free call).

Disaster Areas in 1998	Type of Disaster	Date of Disaster
<b>Alabama</b> Counties of Barbour, Butler, Coffee, Conecuh, Covington, Crenshaw, Dale, Escambia, Geneva, Henry, Houston, and Randolph  Counties of Covington, Cullman, Jefferson, St. Clair, Tuscaloosa, and Walke  Counties of Baldwin, Butler, Choctaw, Clarke, Coffee, Conecuh, Covington, Crenshaw, Escambia, Geneva, Lowndes, Mobile, Monroe, and Washington	Severe storms and flooding  Severe storms and tornadoes  Hurricane Georges	March 7-21, 1998  April 8-20, 1998  September 25-October 6, 1998
<b>California</b> Counties of Alameda, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, Fresno, Glenn, Humboldt, Kern, Lake, Los Angeles, Marin, Mendocino, Merced, Monterey, Napa, Orange, Riverside, Sacramento, San Benito, San Bernadino, San Diego, San Francisco, San Joaquin, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Solano, Sonoma, Stanislaus, Sutter, Tehama, Trinity, Tulare, Ventura, Yolo, and Yuba	Severe winter storms and flooding	February 2-April 30, 1998
<b>Delaware</b> County of Sussex	Severe winter storms, high winds, and flooding	January 28-February 6, 1998

## Florida

Counties of Alachua, Baker, Bay, Bradford, Brevard, Broward, Calhoun, Citrus, Clay, Collier, Columbia, DeSoto, Dixie, Duval, Escambia, Flagler, Franklin, Gadsden, Gilchrist, Glades, Gulf, Hamilton, Hardee, Hernando, Highlands, Hillsborough, Holmes, Jackson, Lafayette, Lake, Levy, Liberty, Madison, Manatee, Marion, Nassau, Okaloosa, Okeechobee, Orange, Osceola, Pasco, Pinellas, Polk, Putnam, Santa Rosa, Sarasota, Seminole, St. Johns, Sumter, Suwannee, Taylor, Union, Volusia, Walton, and Washington

Severe storms, high winds, tornadoes, and flooding

December 25, 1997-April 24, 1998

Counties of Broward, Dade, and Monroe

Severe storms, high winds, tornadoes, and flooding

February 2-4, 1998

Counties of Alachua, Baker, Bay, Bradford, Brevard, Broward, Calhoun, Charlotte, Citrus, Clay, Collier, Columbia, Dade, DeSoto, Dixie, Duval, Escambia, Flagler, Franklin, Gadsden, Gilchrist, Glades, Gulf, Hamilton, Hardee, Hendry, Hernando, Highlands, Hillsborough, Holmes, Indian River, Jackson, Jefferson, Lafayette, Lake, Lee, Leon, Levy, Liberty, Madison, Manatee, Marion, Martin, Monroe, Nassau, Okaloosa, Okeechobee, Orange, Osceola, Palm Beach, Pasco, Pinellas, Polk, Putnam, Santa Rosa, Sarasota, St. Johns, St. Lucie, Seminole, Sumter, Suwannee, Taylor, Union, Volusia, Wakulla, Walton, and Washington

Extreme fire hazards

May 25-July 22, 1998

Counties of Bay, Dixie, Franklin, Gulf, Taylor, and Wakulla

Hurricane Earl

September 3, 1998

Counties of Bay, Calhoun, Columbia, Escambia, Franklin, Gadsden, Gulf, Holmes, Jackson, Jefferson, Liberty, Monroe, Okaloosa, Santa Rosa, Suwannee, Walton, and Washington

Hurricane Georges

September 25-October 7, 1998

Counties of Monroe and Palm Beach

Tropical Storm Mitch

November 4-5, 1998

## Georgia

Counties of Appling, Atkinson, Bacon, Baldwin, Baker, Barrow, Bartow, Ben Hill, Berrien, Bibb, Bleckley, Brantley, Brooks, Bryan, Bulloch, Burke, Butts, Calhoun, Candler, Carroll, Charlton, Chatham, Cherokee, Clay, Clayton, Clinch, Cobb, Coffee, Colquitt, Columbia, Cook, Crawford, Crisp, Dade, Dawson, DeCatur, DeKalb, Dodge, Dooley, Dougherty, Douglas, Early, Echols, Effingham, Emanuel, Evans, Floyd, Forsyth, Fulton, Glynn, Gordon, Grady, Gwinnett, Habersham, Hall, Haralson, Heard, Henry, Houston, Irwin, Jeff Davis, Jefferson, Jenkins, Johnson, Jones, Lamar, Lanier, Laurens, Lee, Liberty, Lincoln, Long, Lowndes, Lumpkin, Macon, McIntosh, Miller, Mitchell, Monroe, Montgomery, Murray, Muscogee, Newton, Paulding, Peach, Pickens, Pike, Pulaski, Quitman, Rabun, Randolph, Richmond, Rockdale, Screven, Seminole, Spalding, Stewart, Sumter, Talbot, Tattnall, Telfair, Terrell, Thomas, Tift, Toombs, Towns, Treutlen, Turner, Twiggs, Union, Walker, Ware, Wayne, Webster, Wheeler, White, Wilcox, Wilkinson, and Worth

Severe storms and flooding

February 14-May 11, 1998

## Indiana

Counties of Benton, Jasper, Lake, LaPorte, Newton, Porter, Pulaski, Saint Joseph, and Starke

Severe storms, tornadoes and flooding

June 11-July 7, 1998

Counties of Benton, Clay, Crawford, Fayette, Franklin, Gibson, Greene, Howard, Knox, Lawrence, Madison, Miami, Monroe, Montgomery, Orange, Owen, Parke, Pike, Putnam, Rush, Sullivan, Union, Vigo, Wayne, and Warren	Severe storms, tornadoes, and flooding	June 11-July 7, 1998
<b>Iowa</b> Counties of Adair, Allamakee, Appanoose, Audubon, Benton, Black Hawk, Boone, Buchanan, Buena Vista, Butler, Calhoun, Carroll, Cass, Cedar, Cerro Gordo, Chickasaw, Clarke, Clay, Clayton, Clinton, Crawford, Dallas, Davis, Decatur, Delaware, Des Moines, Dickinson, Emmet, Fayette, Floyd, Franklin, Fremont, Greene, Grundy, Guthrie, Hamilton, Hancock, Hardin, Harrison, Henry, Howard, Humboldt, Iowa, Jasper, Jefferson, Johnson, Keokuk, Kossuth, Lee, Linn, Louisa, Lucas, Madison, Mahaska, Marion, Marshall, Mills, Monona, Montgomery, Muscatine, Osceola, Page, Palo Alto, Pocahontas, Polk, Pottawattamie, Poweshiek, Ringgold, Sac, Shelby, Story, Tama, Taylor, Union, Wapello, Warren, Washington, Webster, Winnebago, Winneshiek, and Wright	Severe storms, tornadoes, and flooding	June 14, 1998- July 15, 1998
<b>Kansas</b> Counties of Bourbon, Cherokee, Douglas, Franklin, Jackson, Jefferson, Johnson, Leavenworth, Linn, Seward, Wabaunsee, and Wyandotte  Counties of Butler, Chase, Coffey, Cowley, Douglas, Franklin, Greenwood, Harper, Harvey, Johnson, Leavenworth, Lyon, Marion, Neosho, Saline, Sedgwick, Sumner, Wilson, Woodson, and Wyandotte	Severe storms, flooding, and tornadoes  Severe storms and flooding	October 1-8, 1998  October 30- November 15, 1998
<b>Kentucky</b> Counties of Adair, Bath, Boyle, Breathitt, Carter, Casey, Clark, Clay, Clinton, Elliott, Estill, Fleming, Garrard, Greenup, Jackson, Johnson, Knox, Laurel, Lawrence, Lee, Lewis, Lincoln, Madison, Magoffin, McCreary, Menifee, Mercer, Montgomery, Morgan, Nicholas, Owsley, Powell, Pulaski, Robertson, Rockcastle, Rowan, Russell, Wayne, Whitley, and Wolfe  Counties of Adair, Barren, Bell, Breathitt, Casey, Clay, Floyd, Johnson, Knott, Knox, Lawrence, Lee, Leslie, Letcher, Magoffin, Metcalfe, Owsley, Perry, Pike, Warren, and Whitley	Severe winter storm  Severe storms, tornadoes, and flooding	February 4-6, 1998  April 16- May 10, 1998
<b>Louisiana</b> Parishes of Acadia, Ascension, Assumption, Baptist, Cameron, Evangeline, Jefferson, Lafourche, Livingston, Orleans, Plaquemines, St. Bernard, St. Charles, St. James, St. John, St. Martin, St. Mary, St. Tammany, Tangipahoa, Terrebone, Vermilion, and Washington	Tropical Storm Frances and Hurricane Georges	September 9- October 4, 1998
<b>Maine</b> Counties of Androscoggin, Aroostook, Cumberland, Franklin, Hancock, Kennebec, Knox, Lincoln, Penobscot, Piscataquis, Oxford, Sagadahoc, Somerset, Waldo, Washington, and York  Counties of Androscoggin, Franklin, Kennebec, Oxford, Somerset, and York	Severe ice storms, rain, and heavy winds  Severe storms and flooding	January 5-25, 1998  June 13-July 1, 1998

Marshall Islands		
Ailinglaplap, Ailuk, Arno, Aur, Bikini, Ebeye, Ebon, Enewetak, Jabat, Jaluit, Kili, Kwajalein, Lae, Lib, Likiep, Majuro, Maloelap, Mejit, Mili, Namorik, Namu, Ujae, Utrik, Wotho, and Wotje	Severe drought	January 17-June 30, 1998
Massachusetts		
Counties of Bristol, Essex, Middlesex, Norfolk, Plymouth, Suffolk, and Worcester	Heavy rains and flooding	June 13-July 6, 1998
Michigan		
Counties of Bay, Clinton, Gratiot, Ionia, Kent, Mason, Montcalm, Newaygo, Oceana, Ottawa, Saginaw, and Shiawassee	Severe storms and straight-line winds	May 31, 1998
County of Muskegon	Severe storms and straight-line winds	May 29-31, 1998
Counties of Macomb and Wayne	Severe storms and high winds	July 21-22, 1998
Micronesia		
State of Chuuk: Eot, Ettal, Etten, Fanapanges, Fefen, Fonanu, Fono, Houk, Kuttu, Lekinioch, Losap, Makur, Moch, Murillo, Nama, Namoluk, Nomwin, Oneop, Onou, Onoun, Paata, Parem, Piherach, Piis-Emwar, Piis-Paneu, Pollap, Polle, Polowat, Romanum, Ruo, Satowan, Siis, Ta, Tetiw, Tol, Tomatam, Tonoas, Udot, Uman, Unanu, Weno, and Wonei. State of Phonpei: the areas of Kipingamarangi, Mwoakilloa, Nukuoro, Oroluk, Pakin, Pingelap, and Sapwuahfik. State of Yap: Eauripik, Elato, Fais, Faraulap, Ifalik, Lamotrek, Ngulu, Satawal, Sorol, Ulithi, Wolei, and Yap Proper.	Severe drought	January 25-June 30, 1998
Minnesota		
Counties of Blue Earth, Brown, Cottonwood, LaSueur, Nicollet, Nobles, and Rice	Severe storms and tornadoes	March 29, 1998
Counties of Anoka, Blue Earth, Carver, Dakota, Faribault, Fillmore, Freeborn, Goodhue, Hennepin, Houston, Jackson, Mower, Olmsted, Ramsey, Rice, Scott, Wabasha, Washington, and Winona	Severe storms, straight-line winds, and tornadoes	May 15-June 28, 1998
Mississippi		
Counties of Covington, Forrest, George, Greene, Hancock, Harrison, Jackson, Jasper, Jefferson Davis, Jones, Lamar, Marion, Pearl River, Perry, Pike, Stone, and Wayne	Hurricane Georges	September 25-October 5, 1998
Missouri		
Counties of Jackson and St. Louis; and City of St. Louis	Severe storms and flooding	July 10-31, 1998
Counties of Andrew, Barton, Caldwell, Carroll, Cedar, Chariton, Clay, Dade, DeKalb, Jackson, Linn, Livingston, Macon, Miller, Moniteau, Morgan, Platte, Polk, and Ray	Severe storms and flooding	October 4-11, 1998
New Hampshire		
Counties of Belknap, Carroll, Cheshire, Coos, Grafton, Hillsborough, Merrimack, Stafford, and Sullivan	Severe ice storms, rain, and high winds	January 7-25, 1998



Counties of Belknap, Carroll, Grafton, Hillsborough, Merrimack, Rockingham, and Sullivan	Severe storms and flooding	July 12-July 2, 1998
New Jersey Counties of Atlantic, Cape May, and Ocean	Severe winter coastal storm, high winds, and flooding	February 4-9, 1998
New York Counties of Clinton, Essex, Franklin, Genesee, Jefferson, Lewis, Monroe, Niagara, Saratoga, and St. Lawrence	Severe winter and ice storms, high winds, and flooding	January 5-17, 1998
Counties of Broome, Chenango, Otsego, Rensselaer, Saratoga, and Wyoming	Severe thunderstorms and tornadoes	May 31-June 2, 1998
Counties of Allegany, Cattaraugus, Clinton, Delaware, Erie, Essex, Franklin, Genesee, Livingston, Monroe, Steuben, Sullivan, Tioga, Tompkins, and Wyoming	Severe storms and flooding	June 25-July 10, 1998
Counties of Cayuga, Fulton, Herkimer, Madison, Monroe, Nassau, Oneida, Onondaga, Ontario, Orleans, and Wayne	Severe storms and high winds	September 7, 1998
North Carolina Counties of Ashe, Avery, Dare, Haywood, Madison, Mitchell, Robeson, Transylvania, Watauga, and Yancey	Severe storms and flooding	January 7-February 12, 1998
Counties of Durham, Edgecombe, Lenoir, Nash, Rockingham, Wake, and Wayne	Severe storms, tornadoes, and flooding	March 20-April 1, 1998
Counties of Beaufort, Bertie, Bladen, Brunswick, Camden, Carteret, Chowan, Columbus, Craven, Cumberland, Currituck, Dare, Duplin, Greene, Hyde, Jones, Lenoir, Martin, New Hanover, Onslow, Pamlico, Pasquotank, Pender, Perquimans, Pitt, Robeson, Sampson, Tyrrell, Washington, and Wayne	Hurricane Bonnie	August 25-September 1, 1998
North Dakota Counties of Barnes, Benson, Cass, Dickey, LaMoure, Nelson, Pembina, Pierce, Ramsey, Ransom, Richland, Rolette, Sargent, Stutsman, Towner, Walsh; and Indian Reservations of the Spirit Lake Sioux Tribe and the Turtle Mountain Band of Chippewa	Flooding ground saturation, and severe storms	March 2-July 18, 1998
Northern Mariana Islands Island of Rota	Typhoon Paka and associated torrential rains	December 16-17, 1998
Ohio Counties of Athens, Belmont, Coshocton, Franklin, Guernsey, Harrison, Holmes, Jackson, Jefferson, Knox, Meigs, Monroe, Morgan, Morrow, Muskingum, Noble, Ottawa, Perry, Pickaway, Richland, Sandusky, Tuscarawas, and Washington	Severe storms, flooding, and tornadoes	June 24-July 5, 1998
Oregon County of Crook	Flooding	May 28-June 3, 1998
Pennsylvania Counties of Allegheny, Beaver, Berks, Pike, Susquehanna, Somerset, and Wyoming	Severe storms, tornadoes and flooding	May 31-June 2, 1998



Puerto Rico All municipios	Hurricane Georges	September 20- October 27, 1998
South Carolina County of Horry	Hurricane Bonnie	August 25- September 1, 1998
South Dakota Counties of Brown, Clark, Codington, Day, Hanson, Marshall, McCook, Roberts, and Spink	Flooding, severe storms, and tornadoes	April 25-June 22, 1998
Tennessee Counties of Bledsoe, Bradley, Campbell, Cannon, Carter, Chester, Clay, Cocke, Crockett, Cumberland, DeKalb, Fentress, Gibson, Greene, Grundy, Hawkins, Haywood, Jackson, Jefferson, Johnson, Madison, Meigs, Morgan, Overton, Pickett, Polk, Putnam, Rhea, Roane, Scott, Sequatchie, Sevier, Sullivan, Tipton, Unicoi, Van Buren, Warren, Washington, and White	Severe storms and flooding	January 6- February 12, 1998
Counties of Anderson, Blount, Bradley, Campbell, Carroll, Cheatham, Claiborne, Crockett, Davidson, Dickson, Dyer, Gibson, Giles, Grainger, Hamblen, Hancock, Hardin, Hawkins, Humphreys, Jackson, Jefferson, Knox, Lauderdale, Lawrence, Loudon, Macon, Madison, Maury, Monroe, Morgan, Pickett, Polk, Rhea, Roane, Robertson, Scott, Sevier, Shelby, Sumner, Union, Wayne, Williamson, and Wilson	Severe storms, tornadoes, and flooding	April 16-May 18, 1998
Counties of Lawrence and Lewis	Flooding and severe storms	July 13-July 28, 1998
Texas Counties of Edwards, Kimble, Kinney, Maverick, Real, Uvalde, Val Verde, and Webb	Tropical Storm Charley	August 22-31, 1998
Counties of Brazoria, Galveston, Harris, Jefferson, and Matagorda	Severe storms and flooding associated with Tropical Storm Frances	September 9- October 5, 1998
Counties of Austin, Atascosa, Bastrop, Bexar, Blanco, Brazoria, Burleson, Caldwell, Calhoun, Colorado, Comal, DeWitt, Fayette, Fort Bend, Galveston, Goliad, Gonzales, Grimes, Guadalupe, Harris, Hays, Jackson, Jefferson, Jim Wells, Karnes, Kendall, Lavaca, Liberty, Matagorda, Medina, Montgomery, Nueces, Polk, Refugio, San Jacinto, San Patricio, Travis, Trinity, Victoria, Walker, Waller, Wharton, and Wilson	Severe storms, flooding, and tornadoes	October 17- November 15, 1998
U.S. Virgin Islands Islands of St. Croix, St. John, St. Thomas, and Water Island	Hurricane Georges	September 19-22, 1998
Vermont Counties of Addison, Chittenden, Franklin, Grand Isle, Orange, and Windsor	Severe ice storms, rain, high winds, and flooding	January 6-16, 1998
Counties of Addison, Caledonia, Chittenden, Essex, Franklin, Lamoille, Orange, Orleans, Rutland, Washington, and Windsor	Severe storms and flooding	June 17-August 17, 1998

Virginia		
Cities of Chesapeake, Norfolk, Portsmouth, Suffolk, and Virginia Beach	Hurricane Bonnie	August 25-September 1, 1998
Washington		
Counties of Ferry and Stevens	Severe storms and flooding	May 26-29, 1998
City of Kelso (Cowlitz County), specifically the Aldercrest-Banyon subdivision	Landslide	March 6-November 19, 1998
West Virginia		
Counties of Braxton, Cabell, Calhoun, Clay, Doddridge, Gilmer, Harrison, Jackson, Kanawha, Lewis, Marion, Marshall, Ohio, Pleasants, Ritchie, Roane, Tyler, Webster, Wetzel, Wirt, and Wood	Severe storms, flooding, and tornadoes	June 26-July 27, 1998
Wisconsin		
Counties of Buffalo, Clark, Crawford, Dunn, Grant, Jackson, La Crosse, Monroe, Pepin, Pierce, Richland, St. Croix, Trempealeau, and Vernon	Severe storms, straight-line winds, tornadoes, heavy rain, and flooding	June 18-30, 1998
Counties of Milwaukee, Racine, Rock, Sheboygan, and Waukesha	Severe storms and flooding	August 5-15, 1998

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### Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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### Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted federal long-term rate is set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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### Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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### Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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### Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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### Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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### Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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### Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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### Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

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**Insurance companies; interest rate tables.** Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 1998 and 1999. Rev. Rul. 92–19 supplemented in part.

### Rev. Rul. 99–10

For purposes of § 807(d)(4) of the Internal Revenue Code, for taxable years beginning after December 31, 1997, this ruling supplements the schedules of prevailing state assumed interest rates set forth in Rev. Rul. 92–19, 1992–1 C.B. 227. This information is to be used by insurance companies in computing their reserves for (1) life insurance and supplementary total and permanent disability benefits, (2) individual annuities and pure endowments, and (3) group annuities and pure endowments. As § 807(d)(2)(B) requires that the interest rate used to compute these reserves be the greater of (1) the applicable federal interest rate, or (2) the prevailing state assumed interest rate,

the table of applicable federal interest rates in Rev. Rul. 92–19 is also supplemented.

Following are supplements to schedules A, B, C, and D to Part III of Rev. Rul. 92–19, providing prevailing state assumed interest rates for insurance products with different features issued in 1998 and 1999, and a supplement to the table in

Part IV of Rev. Rul. 92–19, providing the applicable federal interest rate under § 807(d) for 1998 and 1999. This ruling does not supplement Parts I and II of Rev. Rul. 92–19.

This is the seventh supplement to the interest rates provided in Rev. Rul. 92–19. Earlier supplements were published in Rev. Rul. 93–58, 1993–2 C.B. 241 (inter-

est rates for insurance products issued in 1992 and 1993), Rev. Rul. 94–11, 1994–1 C.B. 196 (1993 and 1994), Rev. Rul. 95–4, 1995–1 C.B. 141 (1994 and 1995), Rev. Rul. 96–2, 1996–1 C.B. 141 (1995 and 1996), Rev. Rul. 97–2, 1997–1 C.B. 8 (1996 and 1997), and Rev. Rul. 98–2, 1998–2 I.R.B. 15 (1997 and 1998).

### **Part III. Prevailing State Assumed Interest Rates — Products Issued in Years After 1982.\***

#### **Schedule A**

#### **STATUTORY VALUATION INTEREST RATES BASED ON THE 1980 AMENDMENTS TO THE NAIC STANDARD VALUATION LAW**

##### **A. Life insurance valuation:**

<i>Guarantee Duration (years)</i>	<i>Calendar Year of Issue</i>
	1999
10 or fewer	5.00**
More than 10 but not more than 20	4.75**
More than 20	4.50**

Source: Rates calculated from the monthly averages, ending June 30, 1998, of Moody's Corporate Bond Yield Average — Monthly Average Corporates.

\*\* As the applicable federal interest rate for 1999 of 6.30 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.30 percent.

\* The terms used in the schedules in this ruling and in Part III of Rev. Rul. 92–19 are those used in the Standard Valuation Law; the terms are defined in Rev. Rul. 92–19.

#### **Part III, Schedule B**

#### **STATUTORY VALUATION INTEREST RATES BASED ON THE 1980 AMENDMENTS TO THE NAIC STANDARD VALUATION LAW**

B. Single premium immediate annuities and annuity benefits involving life contingencies arising from other annuities with cash settlement options and from guaranteed interest contracts with cash settlement options:

<i>Calendar Year of Issue</i>	<i>Valuation Interest Rate</i>
1998	6.25*

Source: Rates calculated from the monthly averages, ending June 30, 1998, of Moody's Corporate Bond Yield Average — Monthly Average Corporates. The terms used in this schedule are those used in the Standard Valuation Law as defined in Rev. Rul. 92–19.

\*As this prevailing state assumed interest does not exceed the applicable federal interest rate for 1998 of 6.31 percent, the applicable federal interest rate of 6.31 percent is to be used for this product under § 807.

**Part III, Schedule C16 – 1998**

**STATUTORY VALUATION INTEREST RATES BASED ON NAIC STANDARD VALUATION LAW FOR  
1998 CALENDAR YEAR BUSINESS GOVERNED BY THE 1980 AMENDMENTS**

C. Valuation interest rates for other annuities and guaranteed interest contracts that are valued on an issue year basis:

<i>Cash Settlement Options?</i>	<i>Future Interest Guarantee?</i>	<i>Guarantee Duration (years)</i>	<i>Valuation Interest Rate For Plan Type</i>		
			<i>A</i>	<i>B</i>	<i>C</i>
Yes	Yes	5 or fewer	6.25*	5.50*	5.00*
		More than 5, but not more than 10	6.00*	5.50*	5.00*
		More than 10, but not more than 20	5.75*	5.00*	4.75*
		More than 20	4.75*	4.50*	4.50*
Yes	No	5 or fewer	6.50	5.75*	5.25*
		More than 5, but not more than 10	6.25*	5.75*	5.25*
		More than 10, but not more than 20	6.00*	5.25*	5.00*
		More than 20	5.00*	4.75*	4.75*
No	Yes or No	5 or fewer	6.25*		
		More than 5, but not more than 10	6.00*	NOT APPLICABLE	
		More than 10, but not more than 20	5.75*		
		More than 20	4.75*		

Source: Rates calculated from the monthly averages, ending June 30, 1998 of Moody's Corporate Bond Yield Average — Monthly Average Corporates.

\*As the applicable federal interest rate for 1998 of 6.31 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.31 percent.

**Part III, Schedule D16 – 1998**

**STATUTORY VALUATION INTEREST RATES BASED ON NAIC STANDARD VALUATION LAW FOR  
1998 CALENDAR YEAR BUSINESS GOVERNED BY THE 1980 AMENDMENTS**

D. Valuation interest rates for other annuities and guaranteed interest contracts that are contracts with cash settlement options and that are valued on a change in fund basis:

<i>Cash Settlement Options?</i>	<i>Future Interest Guarantee?</i>	<i>Guarantee Duration (years)</i>	<i>Valuation Interest Rate For Plan Type</i>		
			<i>A</i>	<i>B</i>	<i>C</i>
Yes	Yes	5 or fewer	7.00	6.50	5.25*
		More than 5, but not more than 10	6.75	6.50	5.25*
		More than 10, but not more than 20	6.25*	6.00*	5.00*
		More than 20	5.50*	5.50*	4.75*
Yes	No	5 or fewer	7.00	6.75	5.50*
		More than 5, but not more than 10	7.00	6.75	5.50*
		More than 10, but not more than 20	6.50	6.25*	5.25*
		More than 20	5.75*	5.75*	4.75*

Source: Rates calculated from the monthly averages, ending June 30, 1998, of Moody's Corporate Bond Yield Average — Monthly Average Corporates.

\*As the applicable federal interest rate for 1998 of 6.31 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.31 percent.

**Part IV. Applicable Federal Interest Rates.**

TABLE OF APPLICABLE FEDERAL INTEREST RATES FOR PURPOSES OF § 807

<i>Year</i>	<i>Interest Rate</i>
1998	6.31
1999	6.30

Sources: Rev. Rul. 97–50, 1997–49 C.B. 5 for the 1998 rate and Rev. Rul. 98–57, 1998–49 I.R.B. 4 for the 1999 rate.

**EFFECT ON OTHER REVENUE RULINGS**

Rev. Rul. 92–19 is supplemented by the addition to Part III of that ruling of prevailing state assumed interest rates under § 807 for certain insurance products issued in 1998 and 1999 and is further supplemented by an addition to the table in Part IV of Rev. Rul. 92–19 listing applicable federal interest rates. Parts I and II of Rev. Rul. 92–19 are not affected by this ruling.

**DRAFTING INFORMATION**The principal author of this revenue ruling is Ann H. Logan of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact her on (202) 622-3970 (not a toll-free call).

**Internal Revenue Service (I.R.S.)**

**Revenue Ruling**

**INSURANCE COMPANIES; INTEREST RATE TABLES**

*Published: January 12, 1998*

**Insurance companies; Interest rate tables.** Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 1997 and 1998. Rev. Rul. 92-19 supplemented in part.

Prevailing state assumed interest rates are provided for the determination of reserves under section 807 of the Code for contracts issued in 1997 and 1998. Rev. Rul. 92-19 supplemented in part.

For purposes of § 807(d)(4) of the Internal Revenue Code, for taxable years beginning after December 31, 1996, this ruling supplements the schedules of prevailing state assumed interest rates set forth in Rev. Rul. 92-19, 1992-1 C.B. 227. This information is to be used by insurance companies in computing their reserves for (1) life insurance and supplementary total and permanent disability benefits, (2) individual annuities and pure endowments, and (3) group annuities and pure endowments. As § 807(d)(2)(B) requires that the interest rate used to compute these reserves be the greater of (1) the applicable federal interest rate, or (2) the prevailing state assumed interest rate, the table of applicable federal interest rates in Rev. Rul. 92-19 is also supplemented.

Following are supplements to schedules A, B, C, and D to Part III of Rev. Rul.

**Part III. Prevailing State Assumed Interest Rates--Products Issued in Years After 1982. (FN\*)**

**Schedule A**

**STATUTORY VALUATION INTEREST RATES BASED ON THE 1980 AMENDMENTS TO THE NAIC  
STANDARD VALUATION LAW**

**A. Life insurance valuation:**

Guarantee Duration (years)		Calendar Year of Issue
-----		-----
		1998
		-----
	10 or fewer	5.50 (FNaal)
*114	More than 10 but not more than 20	5.25 (FNaal)
	More than 20	4.50 (FNaal)

Note FNSource: Rates calculated from the monthly averages, ending June 30, 1997, of Moody's Corporate Bond Yield Average--Monthly Average Corporates.

Note FNaal. As the applicable federal interest rate for 1998 of 6.31 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.31 percent.

**Part III, Schedule B**

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STATUTORY VALUATION INTEREST RATES BASED ON THE 1980 AMENDMENTS TO THE NAIC  
STANDARD VALUATION LAW

B. Single premium immediate annuities and annuity benefits involving life contingencies arising from other annuities with cash settlement options and from guaranteed interest contracts with cash settlement options:

Calendar Year of Issue	Valuation Interest Rate
-----	-----
1997	6.75 (FNa1)

Note FNSource: Rates calculated from the monthly averages, ending June 30, 1997, of Moody's Corporate Bond Yield Average--Monthly Average Corporates. The terms used in this schedule are those used in the Standard Valuation Law as defined in Rev. Rul. 92"19.

Note FNa1. As this prevailing state assumed interest rate exceeds the applicable federal interest rate for 1997 of 6.33 percent, the prevailing state assumed interest rate of 6.75 percent is to be used for this product under § 807.

**Part III, Schedule C15--1997**

**STATUTORY VALUATION INTEREST RATES BASED ON NAIC STANDARD VALUATION LAW FOR 1997  
CALENDAR YEAR BUSINESS GOVERNED BY THE 1980 AMENDMENTS**

C. Valuation interest rates for other annuities and guaranteed interest contracts that are valued on an issue year basis:

				Valuation Interest Rate For		
				Plan Type		
Cash	Future	Guarantee	Duration	A	B	C
*115 Settlement	Interest		(years)			
Options?	Guarantee?					
-----	-----	-----	-----	-----	-----	-----
Yes	Yes	5 or fewer		6.75	5.75	5.25
					(FNa1)	(FNa1)
		More than 5, but		6.50	5.75	5.25
		not more than 10			(FNa1)	(FNa1)
		More than 10, but		6.00	5.25	5.25
		not more than 20		(FNa1)	(FNa1)	(FNa1)
		More than 20		5.25	4.75	4.75
				(FNa1)	(FNa1)	(FNa1)
Yes	No	5 or fewer		7.00	6.00	5.50
					(FNa1)	(FNa1)
		More than 5, but		6.75	6.00	5.50
		not more than 10			(FNa1)	(FNa1)
		More than 10, but		6.25	5.50	5.25
		not more than 20		(FNa1)	(FNa1)	(FNa1)
		More than 20		5.25	5.00	5.00
				(FNa1)	(FNa1)	(FNa1)
No	Yes or No	5 or fewer		6.75		
		More than 5, but		6.50	NOT APPLICABLE	
		not more than 10				
		More than 10, but		6.00		
		not more than 20		(FNa1)		
		More than 20		5.25		
*116				(FNa1)		

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Note FNSource: Rates calculated from the monthly averages, ending June 30, 1997 of Moody's Corporate Bond Yield Average--Monthly Average Corporates.  
 Note FNa1. As the applicable federal interest rate for 1997 of 6.33 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.33 percent.

#### Part IV. Applicable Federal Interest Rates.

TABLE OF APPLICABLE FEDERAL INTEREST RATES FOR PURPOSES OF § 807

Year	Interest Rate
1997	6.33
1998	6.31

Note FNSources: Rev. Rul. 96"57, 1996"2 C.B. 82 for the 1997 rate and Rev. Rul. 97"50, 1997"49 I.R.B. 5 for the 1998 rate.

#### EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 92-19 is supplemented by the addition to Part III of that ruling of prevailing state assumed interest rates under § 807 for certain insurance products issued in 1997 and 1998 and is further supplemented by an addition to the table in Part IV of Rev. Rul. 92-19 listing applicable federal interest rates. Parts I and II of Rev. Rul. 92-19 are not affected by this ruling.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Ann H. Logan of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact her on (202) 622-3970 (not a toll-free call).

#### Part III, Schedule D15-1997

#### STATUTORY VALUATION INTEREST RATES BASED ON NAIC STANDARD VALUATION LAW FOR 1997 CALENDAR YEAR BUSINESS GOVERNED BY THE 1980 AMENDMENTS

D. Valuation interest rates for other annuities and guaranteed interest contracts that are contracts with cash settlement options and that are valued on a change in fund basis:

*117	Cash Settlement Options?	Future Interest Guarantee?	Guarantee Duration (years)	Valuation Interest Rate For Plan Type		
				A	B	C
	Yes	Yes	5 or fewer	7.50	7.00	5.50 (FNa1)
			More than 5, but not more than 10	7.25	7.00	5.50 (FNa1)
			More than 10, but not more than 20	6.75	6.50	5.25 (FNa1)
			More than 20	5.75	5.75	5.00 (FNa1)
				(FNa1)	(FNa1)	
	Yes	No	5 or fewer	7.75	7.25	5.75 (FNa1)
			More than 5, but	7.50	7.25	5.75 (FNa1)

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not more than 10			
More than 10, but	7.00	6.75	5.50 (FNal)
not more than 20			
More than 20	6.00	6.00	5.25 (FNal)
	(FNal)	(FNal)	

Note FNSource: Rates calculated from the monthly averages, ending June 30, 1997, of Moody's Corporate Bond Yield Average--Monthly Average Corporates.

Note FNal. As the applicable federal interest rate for 1997 of 6.33 percent exceeds this prevailing state assumed interest rate, the interest rate to be used for this product under § 807 is 6.33 percent.

#### EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 92-19 is supplemented by the addition to Part III of that ruling of prevailing state assumed interest rates under § 807 for certain insurance products issued in 1997 and 1998 and is further supplemented by an addition to the table in Part IV of Rev. Rul. 92-19 listing applicable federal interest rates. Parts I and II of Rev. Rul. 92-19 are not affected by this ruling.

#### \*118 DRAFTING INFORMATION

The principal author of this revenue ruling is Ann H. Logan of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact her on (202) 622-3970 (not a toll-free call).

FNal. The terms used in the schedules in this ruling and in Part III of Rev. Rul. 92-19 are those used in the Standard Valuation Law; the terms are defined in Rev. Rul. 92-19.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

## Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

### Determination of issue price in the

case of certain debt instruments issued for property. This ruling provides various prescribed rates for federal income tax purposes for March 1999.

### Rev. Rul. 99–11

This revenue ruling provides various prescribed rates for federal income tax purposes for March 1999 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted

AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 99–11 TABLE 1

Applicable Federal Rates (AFR) for March 1999

*Period for Compounding*

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	4.67%	4.62%	4.59%	4.58%
110% AFR	5.14%	5.08%	5.05%	5.03%
120% AFR	5.62%	5.54%	5.50%	5.48%
130% AFR	6.10%	6.01%	5.97%	5.94%
<i>Mid-Term</i>				
AFR	4.83%	4.77%	4.74%	4.72%
110% AFR	5.32%	5.25%	5.22%	5.19%
120% AFR	5.80%	5.72%	5.68%	5.65%
130% AFR	6.30%	6.20%	6.15%	6.12%
150% AFR	7.29%	7.16%	7.10%	7.06%
175% AFR	8.52%	8.35%	8.26%	8.21%
<i>Long-Term</i>				
AFR	5.30%	5.23%	5.20%	5.17%
110% AFR	5.83%	5.75%	5.71%	5.68%
120% AFR	6.38%	6.28%	6.23%	6.20%
130% AFR	6.92%	6.80%	6.74%	6.71%

REV. RUL. 99–11 TABLE 2

Adjusted AFR for March 1999

*Period for Compounding*

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	3.09%	3.07%	3.06%	3.05%
Mid-term adjusted AFR	3.77%	3.74%	3.72%	3.71%
Long-term adjusted AFR	4.68%	4.63%	4.60%	4.59%

REV. RUL. 99-11 TABLE 3

Rates Under Section 382 for March 1999

Adjusted federal long-term rate for the current month	4.68%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.71%

REV. RUL. 99-11 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for March 1999

Appropriate percentage for the 70% present value low-income housing credit	8.18%
Appropriate percentage for the 30% present value low-income housing credit	3.51%

REV. RUL. 99-11 TABLE 5

Rate Under Section 7520 for March 1999

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.8%
---	------

**Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99-11, page 18.

**Section 6103.—Confidentiality and Disclosure of Returns and Return Information**

26 CFR 6103.301.6103(j)(1)–1: Department of Commerce

**T.D. 8811**

**DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Part 301**

**Disclosure of Return Information to the Bureau of the Census**

AGENCY: Internal Revenue Service (IRS), Treasury.

**ACTION:** Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations relating to additions to, and deletions from, the list of items of information disclosed to the Bureau of the Census for use in certain statistical programs. These regulations provide guidance to IRS personnel responsible for disclosing the information. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in REG-121806-97, on page 46.

**DATES:** *Effective Date:* These regulations are effective January 25, 1999.

*Applicability Date:* For dates of applicability, see §301.6103(j)(1)–1T(e) of these regulations.

**FOR FURTHER INFORMATION CONTACT:** Jamie Bernstein, (202) 622-4570 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

*Background*

Under section 6103(j)(1) of the Internal Revenue Code, upon written request from the Secretary of Commerce, the Secretary is to furnish to the Bureau of the Census (“Bureau”) tax return information that is prescribed by Treasury regulations for the purpose of structuring censuses and national economic accounts and conducting related statistical activities. Section 301.6103(j)(1)–1 of the regulations provides an itemized description of the return information authorized to be disclosed for this purpose. Periodically, the disclosure regulations are amended to reflect the changing needs of the Bureau for data for its statutorily authorized statistical activities.

This document adopts temporary regulations that authorize IRS personnel to disclose the additional items of return information that have been requested by the Secretary of Commerce. The temporary

regulations also delete certain items of return information that are enumerated in the existing regulations but that the Secretary of Commerce has indicated are no longer needed.

Except for §301.6103(j)(1)–1T(b)(3), (b)(6)(i)(A) and (b)(6)(iii), the text of the temporary regulations is the same as 26 CFR 301.6103(j)(1)–1. The changes made by §301.6103(j)(1)–1T(b)(3), (b)(6)(i)(A) and (b)(6)(iii) are discussed below.

#### *Explanation of Provisions*

The request by the Secretary of Commerce for additional items of return information has indicated several areas in which changes to existing Bureau access to tax return information either would improve present statistical programs or are necessary to implement new programs.

To reduce small businesses' direct reporting burden in quinquennial economic censuses and current economic surveys, and to improve the quality of the data received, the Bureau needs certain items of information set forth in tax returns. These items include total expenses or deductions, beginning- and end-of-year inventories, net gain from sales of business property, other income, and total income.

The Secretary of Commerce also has requested identity information of parent corporations as shown on corporate tax returns. This information will enable the Bureau to collect data for various economic surveys at the subsidiary or division level rather than at the establishment level. Restructuring data collection in accordance with such new organizational linkages will reduce the burden on individual business establishments to estimate data relating to their affiliates, enhance the quality of the data collected, and provide the Bureau with an efficient sampling frame for surveys collecting certain data, such as capital expenditures, that are typically not available at the establishment level.

To eliminate the follow-up contact of corporate taxpayers presently required under the Quarterly Financial Report (QFR) program in order to establish S corporation status, the Bureau needs the document code and district office code from corporate returns. Another improvement to the QFR program would be ef-

fectured by the requested disclosure of parent corporation identity information, because subsidiaries could then be linked before a sample was selected and would be relieved of the separate Census reporting requirements. Finally, the Bureau seeks to enhance the quality and reduce the size of sample frames under the QFR program by identifying inactive corporations so that they can be excluded from the universe subject to sampling. This requires that certain items of corporate employment tax information (employer identification number, tax period, total compensation, and taxable wages and tips), available to the Bureau under the existing regulations for economic census purposes, be available to the Bureau as well for QFR purposes.

The Secretary of Commerce has advised that the Bureau no longer uses certain items of information listed in the existing regulations: sales of livestock and produce raised, Schedule E information filed with the Form 1120 series, and, with respect to the QFR program, net income or loss. Accordingly, the temporary regulations have deleted these items from the enumeration of return information to be disclosed to the Bureau.

The transfer of the Census of Agriculture to the Department of Agriculture under the Census of Agriculture Act of 1997 (Public Law 105–113) has also obviated the need for the Secretary of Commerce to receive certain items of information. These items are: Schedule F filed with the Form 1040 series, net farm profits, agricultural activity code, and answers to material participation questions. These items have been deleted in the temporary regulations.

For simplification and consistency, the term “loss” is not expressly stated in these regulations as an alternative to “income” or “gain,” but it is the intent of the Secretary to interpret “income” or “gain” as including negative or loss figures and to provide any such figures to the Bureau.

#### *Special Analyses*

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Pro-

cedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) see the Special Analyses section of the preamble to the cross reference notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### *Drafting Information*

The principal author of these regulations is Douglas Giblen, Office of the Associate Chief Counsel (International) (formerly of the Office of Assistant Chief Counsel (Disclosure Litigation)). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

#### *Adoption of Amendments to the Regulations*

Accordingly, 26 CFR Part 301 is amended as follows:

#### **PART 301—PROCEDURE AND ADMINISTRATION**

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 301.6103(j)(1)–1T also issued under 26 U.S.C. 6103(j)(1); \* \* \*

Par. 2. Section 301.6103(j)(1)–1 is amended by revising paragraphs (b)(3) and (b)(6)(i)(A) to read as follows:

*§301.6103(j)(1)–1 Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.*

\* \* \* \* \*

(b)(3)[Reserved]. For further guidance, see §301.6103(j)(1)–1T(b)(3).

\* \* \* \* \*

(b)(6)(i)(A)[Reserved]. For further guidance, see §301.6103(j)(1)–1T(b)–(6)(i)(A).

\* \* \* \* \*



Par. 3. Section 301.6103(j)(1)–1T is added to read as follows:

*§301.6103(j)(1)–1T Disclosure of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities (temporary).*

(a) through (b)(2)[Reserved]. For further guidance, see §301.6103(j)(1)–1(a) through (b)(2).

(b)(3) Officers or employees of the Internal Revenue Service will disclose the following business related return information reflected on the return of a taxpayer to officers and employees of the Bureau of the Census for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of title 13, United States Code, demographic, economic, and agricultural statistics programs, censuses, and surveys. The “return of a taxpayer” includes, but is not limited to, Form 941; Form 990 series; Form 1040 series and Schedules C and SE; Form 1065 and all attending schedules and Form 8825; Form 1120 series and all attending schedules and Form 8825; Form 851; Form 1096; and other business returns, schedules and forms that the Internal Revenue Service may issue—

(i) Taxpayer identity information (as defined in section 6103(b)(6)) including parent corporation, shareholder, partner, and employer identity information;

(ii) Gross income, profits, or receipts;

(iii) Returns and allowances;

(iv) Cost of labor, salaries, and wages;

(v) Total expenses or deductions;

(vi) Total assets;

(vii) Beginning- and end-of-year inventory;

(viii) Royalty income;

(ix) Interest income, including portfolio interest;

(x) Rental income, including gross rents;

(xi) Tax-exempt interest income;

(xii) Net gain from sales of business property;

(xiii) Other income;

(xiv) Total income;

(xv) Percentage of stock owned by each shareholder;

(xvi) Percentage of capital ownership of each partner;

(xvii) End-of-year code;

(xviii) Months actively operated;

(xix) Principal industrial activity code, including the business description;

(xx) Total number of documents and the total amount reported on the Form 1096 transmitting Forms 1099-MISC;

(xxi) Form 941 indicator and business address on Schedule C; and

(xxii) Consolidated return indicator.

(b)(4) and (5)[Reserved]. For further guidance, see §301.6103(j)(1)–1(b)(4) and (5).

(b)(6)(i) Officers or employees of the Internal Revenue Service will disclose the following return information (but not including return information described in section 6103(o)(2)) reflected on the return of a corporation with respect to the tax imposed by Chapter 1 to officers and employees of the Bureau of the Census for purposes of, but only to the extent necessary in, developing and preparing, as authorized by law, the Quarterly Financial Report—

(A) From the business master files of the Internal Revenue Service—

(1) Taxpayer identity information (as defined in section 6103(b)(6)), including parent corporation identity information;

(2) Document code;

(3) District office code;

(4) Consolidated return and final return indicators;

(5) Principal industrial activity code;

(6) Partial year indicator;

(7) Annual accounting period;

(8) Gross receipts less returns and allowances; and

(9) Total assets.

(b)(6)(i)(B) and (ii)[Reserved]. For further guidance, see §301.6103(j)(1)–1(b)(6)(i)(B) and (ii).

(iii) Information from an employment tax return disclosed pursuant to §301.6103(j)(1)–1(b)(2)(iii)(A), (B), (D), (I) and (J) may be used by officers and employees of the Bureau of the Census for the purpose described in and subject to the limitations of this paragraph (b)(6).

(c) and (d) [Reserved]. For further guidance, see §301.6103(j)(1)–1(c) and (d).

(e) *Effective date.* This section is applicable to the Bureau of the Census on January 25, 1999, through January 22, 2002.

Robert E. Wenzel,  
Deputy Commissioner of  
Internal Revenue.

Approved December 29, 1998.

Donald C. Lubick,  
Assistant Secretary of  
the Treasury.

(Filed by the Office of the Federal Register on January 22, 1999, 8:45 a.m., and published in the issue of the Federal Register for January 25, 1999, 64 F.R. 3669)

## Section 6221.—Tax Treatment Determined at Partnership Level

26 CFR 6221–1T: Tax treatment determined at partnership level (Temporary)

### T.D. 8808

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

### Modifications and Additions to the Unified Partnership Audit Procedures

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations relating to the unified partnership audit procedures added to the Internal Revenue Code by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The unified partnership audit procedures generally provide administrative rules for the auditing of partnership items at the partnership level. These regulations modify the existing unified partnership audit procedures to comply with the Taxpayer Relief Act of 1997 (1997 Act) and the Internal Revenue Service Restructuring and Reform Act of 1998 (1998 Act), and add new regulations to administer the new unified partnership audit provisions added by the 1997 Act. In general, the text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in REG–106564–98, on page 53.

**DATES:** *Effective Date:* These regulations are effective January 26, 1999.

FOR FURTHER INFORMATION CONTACT: Robert G. Honigman, (202) 622-3050 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

This document contains temporary amendments to the Procedure and Administration Regulations (26 CFR Part 301) relating to the unified partnership audit procedures found in sections 6221 through 6233 of the Internal Revenue Code (Code) and final regulations pertaining to the applicable dates of §301.6231(a)(7)-1T(p)(2) and §301.6231(a)(7)-1T(r)(1). Sections 1231 through 1243 of the Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788, modified some of the existing procedures and added certain new rules. Section 3507 of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206, 112 Stat. 685, modified section 6231. This document modifies existing regulations that, because of the 1997 Act or the 1998 Act, no longer reflect current law.

##### *Explanation of Provisions*

##### *Penalties Determined At The Partnership Level*

Before the 1997 Act, the Internal Revenue Service (Service) could impose penalties on a partner only through the application of the deficiency procedures after the completion of a partnership level proceeding. Forcing the Service to open deficiency proceedings against the individual partners was inconsistent with the efficiency goal of the unified partnership audit rules. The 1997 Act cured this problem by providing that, for partnerships under audit for taxable years ending after August 5, 1997, partnership level proceedings include the determination of applicable penalties at the partnership level. Partners now may raise any partner level defenses to the imposition of penalties only in a subsequent refund action.

Consistent with these statutory changes, the temporary regulations mandate that the partnership's penalty defenses are to be resolved during the partnership proceeding. Nevertheless, any individual defenses that a partner may have to the imposition of a penalty may

be brought by the partner in a refund action subsequent to the partnership level determination. In order to minimize the burden on individual partners to defend themselves by bringing their own refund suits, the temporary regulations incorporate a large number of defenses at the partnership level. The majority of a partner's defenses to the imposition of penalties are not specific to a particular partner, but can be determined by reference to the activities of the partnership. The applicability of these defenses may be resolved at the partnership level during the partnership proceeding. In addition, the temporary regulations modify the computational adjustment rules to allow the Service to assess penalties under those procedures.

##### *Partial Settlements*

The period for assessing tax with respect to partnership items generally is the longer of the periods provided by section 6229 or section 6501. For partnership items that convert to nonpartnership items, section 6229(f) provides that the period for assessing tax shall not expire before the date which is one year after the date that the items became nonpartnership items. Section 6231(b)(1)(C) provides that the partnership items of a partner for a partnership taxable year become nonpartnership items as of the date the partner enters into a settlement agreement with the Service with respect to such items. In some audits, however, the taxpayer and the Service will enter into a settlement agreement regarding some, but not all, of the taxpayer's partnership items. The 1997 Act added a special rule for these partial settlement agreements in section 6229(f)(2), providing that the period for assessing any tax attributable to the settled items is determined as if the partial settlement had not been executed. Thus, the limitations period applicable to the last partnership item to be resolved for the partnership's taxable year under audit is controlling with respect to all disputed partnership items (including settled items) for such partnership taxable year.

The temporary regulations state that the one year period for assessing partnership items that convert to nonpartnership items applicable to settlement agreements under section 6231(b)(1)(C) does not apply to partial settlement agreements under sec-

tion 6229(f)(2). Moreover, the temporary regulations clarify that the partner remains subject to the unified audit procedures regarding the nonsettled items.

##### *Tax Matters Partner As A Debtor In Bankruptcy*

Section 6229(b)(1)(B) provides that the statute of limitations under section 6229 is extended with respect to all partners in the partnership by an agreement entered into between the tax matters partner (TMP) and the Service. Treas. Reg. §301.6231(a)(7)-1(l)(1)(iv) (1996) and Temp. Treas. Reg. §301.6231(c)-7T(a) (1987), however, provide that upon the filing of a petition naming a partner as a debtor in a bankruptcy proceeding, the partner/debtor's partnership items convert to nonpartnership items, and if the partner/debtor was the TMP, that status terminates. These rules were promulgated to avoid the complications that the automatic stay provision contained in 11 U.S.C. 362(a)(8) would have on a unified partnership audit. As a result, if a TMP executed a consent to extend the statute of limitations during a period when the TMP was a debtor in a bankruptcy proceeding, the consent would not be binding on the other partners. Under the regulations, the person signing the agreement was ineligible to act as the TMP and extend the statute as to all partners.

To resolve the uncertainty under prior law in the situation where a TMP executes an agreement extending the statute of limitations as to all partners while, unknown to the Service, the TMP is a debtor in a bankruptcy proceeding, the 1997 Act provides that the Service may rely on the executed statute extension agreement unless it is notified of the TMP's bankruptcy proceeding. If the Service is not notified of the TMP's bankruptcy proceeding, statute extensions granted by the TMP are binding on all partners in the partnership.

The temporary regulations provide a mechanism for the TMP, or other partners, to provide notice to the Service that the TMP is a debtor in a bankruptcy proceeding and therefore is ineligible to serve as TMP and extend the statute under section 6229. This mechanism is derived from existing regulations that provide guidance on how to notify the Service of information concerning a partnership's partners.



## Small Partnership Exception

The 1997 Act amended the small partnership exception to the unified partnership audit procedures found in section 6231. Formerly, in order to qualify for the small partnership exception, the partnership had to have 10 or fewer partners at all times during the tax year, each of whom was a natural person (other than a nonresident alien) or an estate, and for which each partner's share of each partnership item was the same as that partner's share of every other partnership item. The 1997 Act amended the small partnership exception by allowing partnerships to qualify for the exception even if they have a C corporation for a partner or specially allocate some partnership items. The temporary regulations modify the existing regulations interpreting the small partnership exception to take account of this change in the law.

### Effective Date

These final and temporary regulations are applicable January 26, 1999. In accordance with section 7805(e)(2), the temporary regulations contained herein shall expire January 25, 2002.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble to the cross reference notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Internal Revenue Code, these final and temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### Drafting Information

The principal authors of these temporary regulations are Robert G. Honigman, Office of the Assistant Chief Counsel

(Passthroughs & Special Industries), and William A. Heard, Office of the Assistant Chief Counsel (Field Service). However, other personnel from the Service and Treasury Department participated in their development.

\* \* \* \* \*

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

#### PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Amend §301.6221-1T by:

1. Redesignating paragraph (c) as paragraph (e).

2. Adding new paragraphs (c) and (d).

The additions read as follows:

*§301.6221-1T Tax treatment determined at partnership level (temporary).*

\* \* \* \* \*

(c) *Penalties determined at partnership level (partnership taxable years ending after August 5, 1997).* Any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item, shall be determined at the partnership level. Partner level defenses to such items can only be asserted through refund actions following assessment and payment. Assessment of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item shall be made based on partnership level determinations. Partnership level determinations include all the legal and factual determinations that underlie the determination of any penalty, addition to tax, or additional amount, other than partner level defenses specified in paragraph (d) of this section.

(d) *Partner level defenses.* Partner level defenses to any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item, may not be asserted in the partnership level proceeding, but may be asserted through separate refund actions following assessment and payment. See section 6230(c)(4).

Partner level defenses are limited to those that are personal to the partner or are dependant upon the partner's separate return, and cannot be determined at the partnership level. Examples of these determinations are: whether any applicable threshold underpayment of tax has been met with respect to the partner or whether the partner has met the criteria of section 6664(b)(penalties applicable only where return is filed), or section 6664(c)(1)(reasonable cause exception) subject to partnership level determinations as to the applicability of section 6664(c)(2).

\* \* \* \* \*

Par. 3. Amend §301.6223(c)-1T by adding a sentence to the end of paragraph (c) to read as follows:

*§301.6223(c)-1T Additional information regarding partners furnished to the Service (temporary).*

\* \* \* \* \*

(c) \* \* \* Furthermore, reference to a prior general notification to the Service that a partner who would otherwise be the tax matters partner is a debtor in a bankruptcy proceeding or has had a receiver appointed for him in a receivership proceeding is not sufficient unless a copy of the notification document referred to is attached to the statement.

\* \* \* \* \*

Par. 4. Amend §301.6224(c)-3T by:

1. Revising the section heading.

2. Revising paragraphs (b), (c)(3)(ii), and (d), *Example (1)*.

The revisions read as follows:

*§301.6224(c)-3T Consistent settlement terms (temporary).*

\* \* \* \* \*

(b) *Requirements for consistent settlement terms—(1) In general.* Consistent settlement terms are those based on the same determinations with respect to partnership items. However, consistent settlement terms also may include partnership level determinations of any penalty, addition to tax, or additional amount that relates to partnership items. Settlements with respect to partnership items shall be self-contained; thus, a concession by one party with respect to a partnership item

may not be based upon a concession by another party with respect to any item that is not a partnership item other than any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item. Consistent agreements, whether comprehensive or partial, must be identical to the original settlement (that is, the settlement upon which the offered settlement terms are based). A consistent agreement must mirror the original settlement and may not be limited to selected items from the original settlement. Once a partner has settled a partnership item, or penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item, that partner may not subsequently request settlement terms consistent with a settlement that contains the previously settled item. The requirement for consistent settlement terms applies only if—

(i) The items were partnership items (and any related penalty, addition to tax, or additional amount) for the partner entering into the original settlement immediately before the original settlement; and

(ii) The items are partnership items (and any related penalty, addition to tax, or additional amount) for the partner requesting the consistent settlement at the time the partner files the request.

(2) *Effect of consistent agreement.* Consistent settlement terms are reflected in a consistent agreement. A consistent agreement is not a settlement agreement which gives rise to further consistent settlement rights because it is required to be given without volitional agreement of the Secretary. Therefore, a consistent agreement required to be offered to a requesting taxpayer is not a settlement agreement under section 6224(c)(2) of the Internal Revenue Code, or paragraph (c)(3) of this section which starts a new period for requesting consistent settlement terms. For all other purposes of the Internal Revenue Code, however, (e.g., binding effect under section 6224(c)(1), and conversion to nonpartnership items under section 6231(b)(1)(C)) a consistent agreement is treated as a settlement agreement.

(c) \* \* \*

(3) \* \* \*

(ii) The 60th day after the day on which the settlement agreement was entered into.

(d) \* \* \*

*Example (1).* The Service seeks to disallow a \$100,000 loss reported by Partnership P. The Service agrees to a settlement with X, a partner in P, in which the Service allows 60 percent of the loss, accepts the treatment of all other partnership items on the partnership return, and imposes a penalty for negligence related to the loss disallowance. Partner Y, which owns a 10 percent interest in the partnership, requests settlement terms which are consistent with the settlement made between X and the Service. The items are partnership items (and a related penalty) for X immediately before X enters into the settlement agreement and are partnership items (and a related penalty) for Y at the time of the request. The Service must offer Y settlement terms allowing a \$6,000 loss, a negligence penalty on the \$4,000 disallowance, and otherwise reflecting the treatment of partnership items on the partnership return.

\* \* \* \* \*

Par. 5. Add §301.6229(b)–2T to read as follows:

*§301.6229(b)–2T Special rule with respect to debtors in Title 11 cases (temporary).*

(a) *In general.* Notwithstanding any other law or rule of law, if an agreement is entered into under section 6229(b)(1)(B), and the agreement is signed by a person who would be the tax matters partner but for the fact that, at the time that the agreement is executed, the person is a debtor in a bankruptcy proceeding under Title 11 of the United States Code, such agreement shall be binding on all partners in the partnership unless the Service has been notified of the bankruptcy proceeding in accordance with paragraph (b) of this section.

(b) *Procedures for notifying the Service of a partner's bankruptcy proceeding.* (1) The Service shall be notified of the bankruptcy proceeding of the tax matters partner in accordance with the procedures set forth in §301.6223(c)–1T.

(2) In addition to the information specified in §301.6223(c)–1T, notification that a person is (or was) a debtor in a bankruptcy proceeding shall include the date the bankruptcy proceeding was filed, the name and address of the court in which the bankruptcy proceeding exists (or took place), the caption of the bankruptcy proceeding (including the docket number or other identification number used by the court), and the status of the proceeding as of the date of notification.

Par. 6. Add §301.6229(f)–1T to read as follows:

*§301.6229(f)–1T Special rule for partial settlement agreements (temporary).*

(a) *In general.* If a partner enters into a settlement agreement with the Service with respect to the treatment of some of the partnership items in dispute for a partnership taxable year, but other partnership items for such year remain in dispute, the period of limitations for assessing any tax attributable to the settled items shall be determined as if such agreement had not been entered into.

(b) *Other items remaining in dispute.* Pursuant to section 6226(c), a partner is a party to a partnership level judicial proceeding with respect to partnership items. When a partner settles partnership items, the settled partnership items convert to nonpartnership items under section 6231(b)(1)(C) and will not be subject to any future or pending partnership level proceeding pursuant to section 6226(d)–(1). The remaining unsettled partnership items, however, will remain subject to determination under partnership level administrative and judicial procedures. Consequently, any remaining unsettled items will be deemed to remain in dispute. Thus, the period for assessing settled items will be governed by the period for assessing the remaining unsettled items.

Par. 7. Amend §301.6231(a)(1)–1T by:

1. Revising the first two sentences of paragraph (a)(1).

2. Removing paragraph (a)(3).

3. Redesignating paragraph (a)(4) as paragraph (a)(3).

The revision reads as follows:

*§301.6231(a)(1)–1T Exception for small partnerships (temporary).*

(a) \* \* \*

(1) “10 or fewer.” The “10 or fewer” limitation described in section 6231(a)–(1)(B)(i) is applied to the number of natural persons (other than nonresident aliens), C corporations, and estates of deceased partners that were partners at any one time during the partnership taxable year. Thus, for example, a partnership that at no time during the taxable year had more than 10 partners may be treated as a small partnership even if, because of transfers of interests in the partnership, 11 or more natural persons, C corporations, or estates of deceased partners owned in-

terests in the partnership for some portion of the taxable year. \* \* \*

\* \* \* \* \*

Par. 8. Amend §301.6231(a)(6)–1T by:

1. Revising paragraph (a).

2. Removing paragraph (c).

The revision reads as follows:

*§301.6231(a)(6)–1T Computational adjustments (temporary).*

(a) *In general.* A change in the tax liability of a partner to properly reflect the treatment of a partnership item under subchapter C of chapter 63 of the Internal Revenue Code is made through a computational adjustment. A computational adjustment includes a change in tax liability that reflects a change in an affected item where that change is necessary to properly reflect the treatment of a partnership item, or any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item. However, if a change in a partner's tax liability cannot be made without making one or more partner level determinations, that portion of the change in tax liability attributable to the partner level determinations shall be made under the provisions of subchapter B of chapter 63 of the Internal Revenue Code (relating to deficiency procedures), except for any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.

(1) Changes in a partner's tax liability with respect to affected items that do not require partner level determinations (such as the threshold amount of medical deductions under section 213 that changes as the result of determinations made at the partnership level) are computational adjustments that are directly assessed. When making computational adjustments, the Service may assume that amounts the partner reported on the partner's individual return include all amounts reported to the partner by the partnership, absent contrary notice to the Service (for example, a "Notice of Inconsistent Treatment"). Such an assumption by the Service does not constitute a partner level determination. Moreover, substituting redetermined partnership items for the partner's previously reported partnership items (including partnership items included in carryover amounts) does not constitute a partner level determination

where the Service otherwise accepts all nonpartnership items (including, for example, nonpartnership item components of carryover amounts) as reported.

(2) Changes in a partner's tax liability with respect to affected items that require partner level determinations (such as a partner's at-risk amount to the extent it depends upon the source from which the partner obtained the funds that the partner contributed to the partnership) are computational adjustments subject to deficiency procedures. Nevertheless, any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item may be directly assessed following a partnership proceeding, based on determinations in that proceeding, regardless of whether partner level determinations are required.

\* \* \* \* \*

Par. 9. Amend §301.6231(a)(7)–1 by adding a sentence at the end of paragraphs (p)(2) and (r)(1) to read as follows:

*§301.6231(a)(7)–1 Designation or selection of tax matters partner.*

\* \* \* \* \*

(p) \* \* \*

(2) \* \* \* For regulations applicable on or after January 26, 1999 (reflecting statutory changes made effective July 22, 1998) and before January 25, 2002, see §301.6231(a)(7)–1T(p)(2).

\* \* \* \* \*

(r) \* \* \* (1) \* \* \* For regulations applicable on or after January 26, 1999 (reflecting statutory changes made effective July 22, 1998) and before January 25, 2002, see §301.6231(a)(7)–1T(r)(1).

\* \* \* \* \*

Par. 10. Add §301.6231(a)(7)–1T to read as follows:

*§301.6231(a)(7)–1T Designation or selection of tax matters partner (temporary).*

(a) through (p)(1) [Reserved]. For further guidance, see §301.6231(a)(7)–1(a) through (p)(1).

(p)(2) *When each general partner is deemed to have no profits interest in the partnership.* If it is impracticable under §301.6231(a)(7)–1(o)(2) to apply the

largest-profits-interest rule of §301.6231(a)(7)–1(m)(2), the Commissioner will select a partner (including a general or limited partner) as the tax matters partner in accordance with the criteria set forth in §301.6231(a)(7)–1(q). The Commissioner will notify, within 30 days of the selection, the partner selected, the partnership, and all partners required to receive notice under section 6223(a), effective as of the date specified in the notice. For regulations applicable before July 22, 1998, see §301.6231(a)(7)–1(p)(2).

(p)(3) through (q) [Reserved]. For further guidance, see §301.6231(a)(7)–1(p)(3) through (q).

(r) *Notification of partnership*—(1) *In general.* If the Commissioner selects a tax matters partner under the provisions of §301.6231(a)(7)–1(p)(1) or (3)(i), the Commissioner will notify, within 30 days of the selection, the partner selected, the partnership, and all partners required to receive notice under section 6223(a), effective as of the date specified in the notice. For regulations applicable before July 22, 1998, see §301.6231(a)(7)–1(r)(1).

(r)(2) [Reserved]. For further guidance, see §301.6231(a)(7)–1(r)(2).

Robert E. Wenzel,  
Deputy Commissioner of  
Internal Revenue Service.

Approved December 30, 1998.

Donald C. Lubick,  
Assistant Secretary of  
the Treasury.

(Filed by the Office of the Federal Register on January 25, 1999, 8:45 a.m., and published in the issue of the Federal Register for January 26, 1999, 64 F.R. 3837)

## Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.

## Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1999. See Rev. Rul. 99–11, page 18.



## Part III. Administrative, Procedural, and Miscellaneous

### Differential Earnings Rate for Mutual Life Insurance Companies

#### Notice 99-13

This notice publishes a tentative determination under § 809 of the Internal Revenue Code of the “differential earnings rate” for 1998 and the rate that is used to calculate the “recomputed differential earnings amount” for 1997. (The latter rate is referred to in this notice as the “recomputed differential earnings rate” for 1997.) These rates are used by mutual life insurance companies to calculate their federal income tax liability for taxable years beginning in 1998.

#### BACKGROUND

Section 809(a) provides that, in the case of any mutual life insurance company, the amount of the deduction allowable under § 808 for policyholder dividends is reduced (but not below zero) by the “differential earnings amount.” Any excess of the differential earnings amount over the amount of the deduction allowable under § 808 is taken into account as a reduction in the closing balance of reserves under subsections (a) and (b) of § 807. The “differential earnings amount” for any taxable year is the amount equal to the product of (a) the life insurance company’s average equity base for the taxable year multiplied by (b) the “differential earnings rate” for that taxable year. The “differential earnings rate” for the taxable year is the excess of (a) the “imputed earnings rate” for the taxable year over (b) the “average mutual earnings rate” for the second calendar year preceding the calendar year in which the taxable year begins. The “imputed earnings rate” for any taxable year is the amount that bears the same ratio to 16.5 percent as the “current stock earnings rate” for the taxable year bears to the “base period stock earnings rate.”

Section 809(f) provides that, in the case of any mutual life insurance company, if the “recomputed differential earnings amount” for any taxable year exceeds the differential earnings amount for that taxable year, the excess is included in life in-

surance gross income for the succeeding taxable year. If the differential earnings amount for any taxable year exceeds the recomputed differential earnings amount for that taxable year, the excess is allowed as a life insurance deduction for the succeeding taxable year. The “recomputed differential earnings amount” for any taxable year is an amount calculated in the same manner as the differential earnings amount for that taxable year, except that the average mutual earnings rate for the calendar year in which the taxable year begins is substituted for the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

The stock earnings rates and mutual earnings rates taken into account under § 809 generally are determined by dividing statement gain from operations by the average equity base. For this purpose, the term “statement gain from operations” means “the net gain or loss from operations required to be set forth in the annual statement, determined without regard to Federal income taxes, and . . . properly adjusted for realized capital gains and losses. . . .” See § 809(g)(1). The term “equity base” is defined as an amount determined in the manner prescribed by regulations equal to surplus and capital increased by the amount of nonadmitted financial assets, the excess of statutory reserves over the amount of tax reserves, the sum of certain other reserves, and 50 percent of any policyholder dividends (or other similar liability) payable in the following taxable year. See § 809(b)(2), (3), (4), (5) and (6). Section 1.809-10 of the Income Tax Regulations provides that the equity base includes both the asset valuation reserve and the interest maintenance reserve for taxable years ending after December 31, 1991.

Section 1.809-9(a) of the regulations provides that neither the differential earnings rate under § 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under § 809(f)(3) may be less than zero.

Rev. Rul. 99-3, 1999-3 I.R.B. 4, provides that a life insurance subsidiary of a mutual holding company is not a mutual

life insurance company for which the deduction for policyholder dividends is reduced pursuant to §§ 808(c)(2) and 809.

As described above, the differential earnings rate for 1998 and the recomputed differential earnings rate for 1997 affect the income and deductions reported by mutual life insurance companies on their federal income tax returns for the 1998 taxable year.

Data necessary to determine the tentative differential earnings rate for 1998 and the tentative recomputed differential earnings rate for 1997 have been compiled from returns filed by mutual life insurance companies and certain stock life insurance companies. The Internal Revenue Service is currently examining these returns. This examination will not be completed before the March 15, 1999, due date for filing 1998 calendar year returns.

#### NOTICE OF TENTATIVE RATES

This notice publishes a tentative determination of the differential earnings rate for 1998 and of the recomputed differential earnings rate for 1997. This notice also publishes a tentative determination of the rates on which the calculation of the differential earnings rate for 1998 and the recomputed differential earnings rate for 1997 are based. The final determination of these rates is expected to be published before September 1, 1999.

The tentative determination of the differential earnings rate for 1998 and the tentative determination of the recomputed differential earnings rate for 1997 that are published in this notice should be used by mutual life insurance companies to calculate the amount of tax liability for taxable years beginning in 1998 (in the case of companies that file returns before publication of the final determination of these rates) or to calculate the amount of estimated unpaid tax liability for taxable years beginning in 1998 (in the case of companies that are allowed an extension of time to file returns). Companies that file returns before publication of the final determination of these rates should file amended returns after the final determination of these rates is published. If there is a failure to pay tax for a taxable year beginning in 1998 and the failure is attribut-

able to a difference between (a) the tentative determination of the differential earnings rate for 1998 and recomputed differential earnings rate for 1997 and (b) the final determination of these rates, then any such failure through September 15, 1999, will be treated as due to reasonable cause and will not give rise to any addition to tax under § 6651.

The tentative determination of the rates is set forth in Table 1.

#### DRAFTING INFORMATION

The principal author of this notice is Katherine A. Hossofsky of the Office of the Assistant Chief Counsel (Financial Institutions and Products). For further in-

formation regarding this notice, contact Ms. Hossofsky on (202) 622-3477 (not a toll-free call).

Notice 99-13      Table 1	
Tentative Determination of Rates To Be Used For Taxable Years Beginning in 1998	
Differential earnings rate for 1998 .....	0.081
Recomputed differential earnings rate for 1997 .....	0
Imputed earnings rate for 1997 .....	13.813
Imputed earnings rate for 1998 .....	16.193
Base period stock earnings rate .....	18.221
Current stock earnings rate for 1998 .....	17.882
Stock earnings rate for 1995 .....	17.087
Stock earnings rate for 1996 .....	17.238
Stock earnings rate for 1997 .....	19.321
Average mutual earnings rate for 1996 .....	16.112
Average mutual earnings rate for 1997 .....	15.566

## Part IV. Items of General Interest

### Notice of Proposed Rulemaking and Notice of Public Hearing

#### Escrow Funds and Other Similar Funds

#### REG-209619-93

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the designation of the person required to report the income earned on qualified settlement funds and certain other funds, trusts, and escrow accounts, and other related rules. The proposed regulations would affect qualified settlement funds, qualified escrow accounts and qualified trusts established in connection with deferred like-kind exchanges, escrow accounts established in connection with sales of property, disputed ownership funds, and parties to these escrow accounts, trusts, and funds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by May 3, 1999. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for May 12, 1999, at 10 a.m., must be received by April 21, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-209619-93), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-209619-93), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the INTERNET by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS INTERNET site at [http://www.irs.us-treas.gov/prod/tax\\_regs/comments.html](http://www.irs.us-treas.gov/prod/tax_regs/comments.html). The public hearing will be held in Room

2615, Internal Revenue Building, 1111 Constitution Avenue, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Michael L. Gompertz of the Office of Assistant Chief Counsel (Income Tax & Accounting), (202) 622-4910; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### *Paperwork Reduction Act*

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by April 1, 1999. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in this proposed regulation are in §§1.468B-1(k)(2), 1.468B-1(k)(3)(iv), 1.468B-6(e)(1), 1.468B-6(f), 1.468B-7(d), 1.468B-8(f), 1.468B-8(g)(1), 1.468B-9(c)(1), and 1.468B-9(f)(3).

The collections of information in §§1.468B-1(k)(3)(iv), 1.468B-6(e)(1), 1.468B-7(d), 1.468B-8(g)(1), and 1.468B-9(c)(1) are satisfied by including the required information on Forms 1099, 1041, 1120, or 1120-SF. The burden for these requirements is reflected in the burden estimates for these forms.

The other collections of information in this proposed regulation (in §§1.468B-1(k)(2), 1.468B-6(f), 1.468B-8(f), and 1.468B-9(f)(3)) are discussed below.

The collection of information in §1.468B-1(k)(2) is an election statement attached to a tax return filed for a qualified settlement fund (QSF). The statement notifies the IRS that the transferor to the QSF has elected grantor trust treatment for the QSF. This collection is required to obtain a benefit.

The collections of information in §§1.468B-6(f) and 1.468B-8(f) are statements that third parties must provide to an escrow holder, trustee, or administrator to enable the escrow holder, trustee, or administrator to properly report the income of an escrow account or trust on Form 1099. These collections are mandatory.

The collection of information in §1.468B-9(f)(3) is a statement that a transferor must provide with respect to the transfer of cash or property to a disputed ownership fund. This collection is mandatory.

The likely respondents are individuals, business or other for-profit institutions, small businesses or organizations, non-profit institutions, and government entities.

Estimated total annual reporting burden: 4,650 hours.

Estimated average annual burden per respondent: .5 hours.

Estimated number of respondents: 9,300.

Estimated annual frequency of responses: on occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the col-

lection of information displays a valid control number assigned by the Office of Management and Budget.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

### *Background*

This notice contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 468B of the Internal Revenue Code. Section 468B was added to the Code by section 1807(a)-(7)(A) of the Tax Reform Act of 1986 (Public Law 99-514, 100 Stat. 2814) and was amended by section 1018(f) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647, 102 Stat. 3582). Section 468B(g) provides that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. Section 468B(g) further provides that the Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

On December 23, 1992, final regulations (TD 8459, 1993-1 C.B. 68) under section 468B(g) were published in the **Federal Register** (57 F.R. 60983). The regulations provide guidance concerning qualified settlement funds, but do not address other types of funds, escrow accounts, or trusts subject to current taxation under section 468B(g).

Section 1.468B-1(c) defines a qualified settlement fund (QSF) as a fund, account, or trust meeting three requirements. A QSF is a separate taxpayer subject to tax on its modified gross income. QSF classification is not elective. The preamble to the QSF regulations (see 1993-1 C.B. 69) states that the IRS and the Treasury Department rejected an elective approach because it would result in inconsistent tax treatment for similar funds, claimants, or transferors, and accompanying complexity.

The preamble to the QSF regulations also states (see 1993-1 C.B. 73) that future regulations will address the tax treat-

ment of funds, accounts, or trusts other than QSFs, specifically, escrow accounts used in the sale of property and section 1031 qualified escrow accounts.

Section 1031(a)(3) was added to the Internal Revenue Code by section 77 of the Tax Reform Act of 1984 (Public Law 98-369, 98 Stat. 595). On May 1, 1991, final regulations (TD 8346, 1991-1 C.B. 150) under section 1031(a)(3) were published in the **Federal Register** (56 F.R. 19933). These regulations were amended by final regulations (TD 8535, 1994-1 C.B. 202) published in the **Federal Register** for April 20, 1994 (59 F.R. 18747). The regulations provide four safe harbors, the use of any of which will result in a determination that the taxpayer (i.e., the party transferring the property in the exchange) is not in actual or constructive receipt of money or other property for purposes of section 1031. In particular, the regulations provide that the taxpayer is not in actual or constructive receipt of money or other property held in a qualified escrow account or qualified trust. Section 1.1031(k)-1(g)(3) defines *qualified escrow account* and *qualified trust*.

The regulations under section 1031(a)(3) do not address the taxation of income earned on a qualified escrow or qualified trust. The preamble to these regulations (see 1991-1 C.B. 154) states that this issue will be addressed in future regulations.

### *Explanation of Provisions*

#### *1. Election to Treat a QSF as a Grantor Trust Under §1.468B-1(k) of the Proposed Regulations.*

The proposed regulations provide that if there is only one transferor to a QSF, the transferor is allowed to make an election that results in the QSF being treated as a grantor trust all of which is treated as owned by the transferor. In general, the election is made on a statement attached to the first Form 1041 filed on behalf of the QSF. The transferor may make a grantor trust election whether or not the requirements are otherwise satisfied for classification of the QSF as a grantor trust.

In general, grantor trust treatment for a QSF is available under the proposed regulations only if the QSF is established after the date final regulations are published in the **Federal Register**. However, the pro-

posed regulations provide a narrow exception applicable to any QSF established by the U.S. government on or before the date final regulations are published if the QSF would otherwise have been classified as a grantor trust in the absence of the QSF regulations (see Rev. Rul. 77-230 (1977-2 C.B. 214)). Under the exception, such a QSF will be automatically treated as a grantor trust for all taxable years and a grantor trust election is thus unnecessary. If a QSF is established after the date final regulations are published, a grantor trust election will be required in order for the QSF to be treated as a grantor trust. This rule applies whether or not the U.S. government is the grantor.

#### *2. Section 1031 Qualified Escrow Accounts and Qualified Trusts Under §1.468B-6 of the Proposed Regulations.*

In general, the proposed regulations treat the assets of a qualified escrow account or qualified trust established in connection with a deferred exchange under section 1031(a)(3) as owned by the taxpayer, i.e., the party that transfers the relinquished property. Thus, the taxpayer is taxable on the income earned on these assets. However, if the transferee or the qualified intermediary has all the beneficial use and enjoyment of the assets of a qualified escrow account or qualified trust, then the assets of the escrow account or trust are treated as owned by the transferee or qualified intermediary, and the income earned on the assets is taxable to the transferee or qualified intermediary.

Further, the proposed regulations require the escrow holder of a qualified escrow account or trustee of a qualified trust to report the income of the escrow account or trust on Forms 1099 to the extent the information reporting provisions of the Code otherwise require the filing of Forms 1099. In general, the taxpayer is treated as the payee of the income of the escrow account or trust unless the parties to the transaction provide a statement to the escrow holder or trustee indicating that the transferee or qualified intermediary is the payee. Such a statement must be provided if the transferee or qualified intermediary has all the beneficial use and enjoyment of the assets of the escrow account or trust.



The proposed regulations provide that the escrow holder or trustee is not liable for penalties under sections 6721 and 6722 if the escrow holder or trustee relies on an incorrect statement provided to the escrow holder or trustee (see above) or relies on the parties' failure to provide such a statement.

The proposed regulations also provide that if the transferee or the qualified intermediary has all the beneficial use and enjoyment of the assets of a qualified escrow account or trust, the deferred exchange may involve a below-market loan of these assets from the taxpayer to the transferee or qualified intermediary subject to the provisions of section 7872.

### 3. *Pre-closing Escrows Under §1.468B-7 of the Proposed Regulations.*

A pre-closing escrow is an escrow account, trust, or fund that satisfies five requirements. First, it must be established in connection with a sale or exchange of real or personal property. Second, it must be funded with a down payment, earnest money, or similar payment prior to the sale or exchange of the property (as determined for federal income tax purposes). Third, its assets must be used to secure the purchaser's obligation to pay the purchase price (in the case of an exchange of property, the term purchaser means the transferee of the property and the term purchase price means the required consideration for the property). Fourth, its assets (including income earned thereon) must be paid to the purchaser or otherwise used for the purchaser's benefit, for example, as a credit against the purchase price. Fifth, it must not be a qualified escrow or qualified trust established in connection with a deferred section 1031 exchange.

The proposed regulations treat the assets of a pre-closing escrow as owned by the purchaser for federal income tax purposes. Thus, the income earned on the assets is taxable to the purchaser. The escrow holder, trustee, or other person responsible for administering a pre-closing escrow must report the income of the escrow on Forms 1099 to the extent the information reporting provisions of the Code otherwise require the filing of Forms 1099.

### 4. *Contingent At-closing Escrows Under §1.468B-8 of the Proposed Regulations.*

The proposed regulations provide rules for taxing the income of a contingent at-closing escrow, which is an escrow account, trust, or fund satisfying three requirements. First, a contingent at-closing escrow must be established in connection with the sale or exchange of real or personal property used in a trade or business or held for investment (other than an exchange to which section 354, 355, or 356 applies). Second, the assets of the escrow must be distributable to the purchaser or seller based on bona fide contingencies that will be resolved after the sale or exchange (as determined for federal income tax purposes). (If a contingent at-closing escrow is established in connection with an exchange of property, rather than a sale, the term *purchaser* refers to the transferee of the property and the term *seller* refers to the transferor of the property.) Thus, for example, the agreement between the parties may provide that all or a portion of the assets of the escrow are distributable to the purchaser if specified liabilities associated with the property arise within a specified period of time after closing or if certain earnings targets are not met by a specified date. Third, the escrow must not be a qualified escrow account or qualified trust established in connection with a deferred section 1031 exchange.

Prior to the date (called the determination date) on which the specified events occur or fail to occur, thereby fixing the amounts payable from the escrow to the purchaser and seller, the proposed regulations provide that the assets of the escrow are treated as owned by the purchaser, and the income earned on the assets is thus taxable to the purchaser.

Beginning on the determination date, the proposed regulations provide that the purchaser and the seller are taxable on the income of the escrow corresponding to their respective ownership interests in each asset of the escrow. Further, the proposed regulations require the purchaser and seller to provide the escrow holder, trustee, or other administrator of the escrow with a statement within 30 days of the determination date indicating what these ownership interests are. Also, the escrow holder, trustee, or other adminis-

trator is required to prepare Forms 1099 to report the income of a contingent at-closing escrow to the extent the information reporting provisions of the Code otherwise require the filing of Forms 1099.

In preparing the Forms 1099, the escrow holder, trustee, or other administrator may rely on the statement (discussed above) provided to the administrator within 30 days of the determination date. Also, if the statement is not provided, the escrow holder, trustee, or other administrator may rely on the parties' failure to provide a statement and continue to treat the purchaser as the owner. The administrator's ability to rely on a statement, or its absence, protects the administrator from liability for penalties under sections 6721 and 6722.

### 5. *Disputed Ownership Funds Under §1.468B-9 of the Proposed Regulations.*

A disputed ownership fund (DOF) is an escrow account, trust, or fund other than a QSF that satisfies three requirements. First, a DOF must be established to hold money or property subject to conflicting claims of ownership. Second, a DOF must be subject to the continuing jurisdiction of a court of law or equity. Third, money or property cannot be paid or distributed from a DOF to a claimant without court approval. An interpleader fund may qualify as a DOF.

In general, a DOF is taxed under the proposed regulations as if it were a qualified settlement fund if all the DOF's assets are passive investment assets, for example, cash or cash equivalents, stock, and debt obligations. However, if the DOF holds assets other than passive investment assets (for example, real estate or business property the ownership of which is in dispute), the DOF is taxed as if it were a C corporation. The claimants to the fund may, however, submit a letter ruling request proposing an alternative method of taxation if they believe that there is a more appropriate method of taxing a DOF than under the rules stated above.

In addition to providing rules for the taxation of the income of a DOF, the proposed regulations also provide rules concerning the transfer of property to and from a DOF. In particular, a transfer of property to a DOF is not a sale or other

disposition by the transferor under section 1001(a) if the transferor claims ownership of the transferred property. Also, a DOF is not allowed a deduction for a distribution of disputed property to a claimant and the distribution is not a taxable event to the DOF.

#### 6. *Request for Comments*

Comments are requested on the appropriate tax treatment of a fund, account, or trust that meets the requirements for more than one type of entity subject to the proposed regulations. Comments are also requested on the appropriate tax treatment of a fund, account, or trust that changes over time so that a different portion of the proposed regulations would apply to it. For example, an escrow initially may meet the requirements for a contingent at-closing escrow, but may subsequently satisfy the requirements for a DOF. This could occur if a dispute were to arise between the purchaser and the seller concerning their respective interests in the escrow after the determination date and the administrator of the DOF files an interpleader action to resolve the dispute.

Comments are also requested concerning the appropriate tax treatment of a contingent-at-closing escrow if multiple contingencies are specified in the agreement between the purchaser and the seller. The proposed regulations provide that (1) the income of a contingent at-closing escrow is taxable entirely to the purchaser prior to the determination date, and (2) the determination date is the date on which (or by which) the last of the contingent events has either occurred or failed to occur. Therefore, if multiple contingencies are provided for in the agreement between the parties and some, but not all, of the contingencies have been resolved, the proposed regulations provide that the income of the escrow is taxable entirely to the purchaser (because the determination date has not yet occurred) regardless of the effect of the contingencies that have been resolved. The purchaser is thus taxed on all the income earned on the escrow even though it may be known (based on the resolution of one or more contingencies) that a fixed portion of the escrowed assets will be distributed to the seller. The proposed rule is simple and easy to administer because it treats the escrow in a unitary manner and avoids the need for

multiple determination dates. Arguably, however, a more complex approach should be adopted involving a separate determination date for each contingency. Under the more complex approach, as each contingency is resolved, a new determination would be made concerning the taxation of the fund's income. The income earned on the fund's assets would be taxable to the purchaser and seller in accordance with their ownership interests as determined on each determination date as each separate contingency is resolved.

Comments are also requested on the requirement that the assets of a contingent at-closing escrow must be distributable to the purchaser or seller based on bona fide contingencies that are resolved after the sale or exchange. Issues may arise as to whether a particular contingency is bona fide in at least two ways: whether the outcome is sufficiently in doubt and whether the effect of the outcome on the fund is significant. A contingency may not be bona fide if the parties can reasonably be expected to know the outcome, e.g., a contingency based on whether, in ten years, the consumer price index will be at least equal to the consumer price index today. In addition, a contingency may not be bona fide if the effect on the fund is minimal even though the outcome is uncertain.

Finally, comments are requested regarding whether there are other types of funds for which rules under section 468B are required.

#### 7. *Proposed Effective Date.*

In general, the regulations are proposed to be applicable for QSFs, qualified escrow accounts and qualified trusts, pre-closing escrows, contingent at-closing escrows, and DOFs established after the date final regulations are published in the **Federal Register**. However, the proposed regulations contain transition rules.

#### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of pro-

posed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. An initial regulatory flexibility analysis has been prepared for the collections of information contained in this notice of proposed rulemaking under 5 U.S.C. 603. The analysis is set forth below.

#### *Initial Regulatory Flexibility Act Analysis*

The objective of the proposed regulations is to ensure that the income of certain escrow accounts, trusts, and funds is subject to current taxation by identifying the proper party or parties subject to tax and by requiring appropriate information reporting for the income of the escrow account, trust, or fund. Section 468B(g) provides the legal basis for the requirements of the proposed regulations. The IRS and Treasury Department are not aware of any federal rules that may duplicate, overlap, or conflict with the proposed regulations.

An explanation is provided below of the burdens on small entities resulting from the requirements of the proposed regulations. Also, a description is provided of alternative rules that were considered by the IRS and the Treasury Department but rejected as too burdensome.

##### 1. *Grantor Trust Election Under §1.468B-1(k).*

Under §1.468B-1(k), the transferor to a QSF may elect to have the QSF treated as a grantor trust all of which is treated as owned by the transferor (grantor trust election). If the transferor makes the grantor trust election, the administrator of the QSF must file Form 1041 rather than the QSF income tax return, Form 1120-SF.

Approximately 900 QSF returns are filed each year. Only a small number of these returns are filed for newly created QSFs. Because a grantor trust election may be made only for the year in which a QSF is established, and may only be made for a QSF that has one transferor, the IRS and Treasury Department believe that a very small number of grantor trust elections will be made each year.

Because of the availability of the grantor trust election, the proposed regulations provide a choice of filing Form 1041 or Form 1120-SF in certain situa-

tions. Small entities may choose the filing requirement that is less burdensome.

The alternative to the proposed regulations is to retain the current rules for QSFs and not provide qualifying taxpayers with the opportunity to make a grantor trust election.

## 2. *Qualified Escrow Accounts and Qualified Trusts Established in Connection with Deferred Exchanges; Pre-closing Escrows; and Contingent At-closing Escrows.*

Sections 1.468B-6(e)(1), 1.468B-7(d), and 1.468B-8(g)(1) require specified escrow holders, trustees, and administrators to file Forms 1099 with the IRS and furnish payee statements in accordance with the information reporting requirements of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code.

Also, §1.468B-6(f) requires the parties to a qualified escrow account or qualified trust to provide a statement to the escrow holder or trustee if the qualified intermediary or transferee has all the beneficial use and enjoyment of the assets of the escrow account or trust. This statement facilitates the filing of Forms 1099 by the escrow holder or trustee.

Similarly, §1.468B-8(f) requires the parties to a contingent at-closing escrow to provide statements to the escrow holder or other administrator. These statements facilitate the filing of Forms 1099 by the escrow holder or other administrator.

The IRS and Treasury Department estimate that annually there are approximately 16,000 deferred exchange transactions involving the creation of a qualified escrow account or qualified trust; approximately 200,000 transactions involving the creation of a pre-closing escrow; and approximately 10,000 transactions involving the creation of a contingent at-closing escrow.

As an alternative to the proposed regulations, the IRS and the Treasury Department considered, but rejected as too burdensome, a rule that would have required the filing of grantor trust returns (Form 1041) for qualified escrow accounts and qualified trusts, pre-closing escrows, and contingent at-closing escrows. Instead of requiring grantor trust returns, the proposed regulations require the filing of Forms 1099. This is less burdensome on

small entities because, unlike Form 1041, Form 1099 is simple, does not require a signature, and requires only the reporting of gross income.

Further, the IRS and the Treasury Department considered an alternative rule for contingent at-closing escrows under which the income of the escrow for the period before the determination date would have been taxable to the purchaser or the seller depending on the required tax treatment by the purchaser and seller of the principal amount deposited into the escrow. This alternative rule would not have provided certainty, would have required a difficult legal analysis (namely, the determination of the required tax treatment of the principal amount deposited into the escrow), and would have required the purchaser and seller to provide a signed statement to the administrator of the escrow identifying the party to whom the administrator should report the income for the period before the determination date. Under the proposed regulations, the income of the escrow is always taxable to the purchaser for the period before the determination date, thereby eliminating the need for a signed statement to be provided to the administrator and the need to determine the required tax treatment of the principal amount deposited into the escrow. This rule is simpler than the alternative.

## 3. *Disputed Ownership Funds (DOFs).*

Section 1.468B-9(c)(1) of the proposed regulations generally provides that a DOF is taxable as a QSF if all its assets are passive investment assets or taxable as a C corporation in all other cases. However, the regulations also provide that if there is a more appropriate method of taxing a DOF, the claimants to the fund may request a private letter ruling to permit the use of that method.

Section 1.468B-9(f)(3) of the proposed regulations requires that a transferor provide a statement to the administrator of a DOF that itemizes the cash or property transferred to the DOF during the calendar year. The statement must also indicate the DOF's basis and holding period in the property.

The IRS and the Treasury Department estimate that annually there are approximately 5,000 transactions involving the creation of a disputed ownership fund.

As an alternative to the proposed regu-

lations, the IRS and the Treasury Department considered, but rejected as too burdensome, a rule that would have required all DOFs to file corporate income tax returns (Form 1120) regardless of the nature of the assets held by the DOF. This alternative was rejected because it was concluded that a QSF return (Form 1120-SF) is more appropriate than a corporate income tax return if all the assets of the DOF are passive investment assets. The proposed regulations thus impose less of an administrative burden on small entities than would have resulted from the alternative rule as Form 1120-SF is generally easier to prepare than Form 1120. Only DOFs that hold assets other than passive investment assets will be required to file Form 1120 under the proposed regulations. In addition, the proposed regulations provide taxpayers with the additional flexibility of being able to request an alternative method of taxation if that method is more appropriate than QSF or C corporation treatment as provided under the general rule.

There are no known alternative rules that are less burdensome to small entities but that accomplish the purpose of the statute. The IRS and Treasury Department request comments from small entities concerning possible alternatives to these rules.

## *Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely (in the manner described in the ADDRESSES portion of the preamble) to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing is scheduled for May 12, 1999, at 10 a.m. in Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access re-



strictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments by May 3, 1999, and submit an outline of the topics to be discussed and the time devoted to each topic (signed original and eight (8) copies) by April 21, 1999.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### *Drafting Information*

The principal author of these proposed regulations is Michael L. Gompertz of the Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

#### *Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### **PART 1—INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.468B-6 also issued under 26 U.S.C. 468B.

Section 1.468B-7 also issued under 26 U.S.C. 468B.

Section 1.468B-8 also issued under 26 U.S.C. 468B.

Section 1.468B-9 also issued under 26 U.S.C. 468B. \* \* \*

Par. 2. Section 1.468B-0 is amended as follows:

1. The introductory text is revised.

2. The entry for §1.468B-1, paragraph (k), is redesignated as paragraph (l).

3. A new entry for §1.468B-1, paragraph (k), is added.

4. The section heading in the entry for §1.468B-5 is revised.

5. New entries are added for §§1.468B-5, paragraph (c), 1.468B-6, 1.468B-7, 1.468B-8, and 1.468B-9.

6. The revised and added provisions read as follows:

#### *§1.468B-0 Table of contents.*

This section lists the table of contents for §§1.468B-1 through 1.468B-9.

#### *§1.468B-1 Qualified settlement funds.*

\* \* \* \* \*

(k) Election to treat a qualified settlement fund as a subpart E trust.

(1) In general.

(2) Manner of making grantor trust election.

(i) In general.

(ii) Requirements for election statement.

(3) Effect of making the election.

\* \* \* \* \*

#### *§1.468B-5 Effective dates and transition rules applicable to qualified settlement funds.*

\* \* \* \* \*

(c) Grantor trust elections under §1.468B-1(k).

(1) In general.

(2) Qualified settlement funds established by the U.S. government on or before the date of publication of final regulations in the **Federal Register**.

#### *§1.468B-6 Qualified escrow accounts and qualified trusts used in deferred exchanges of like-kind property under section 1031(a)(3).*

(a) Scope.

(b) Definitions.

(c) Income of qualified escrow account or qualified trust.

(1) In general.

(2) Transferee or qualified intermediary has all the beneficial use and enjoyment of assets of a qualified escrow account or qualified trust.

(d) Application of section 7872.

(e) Reporting obligations of the escrow holder or trustee.

(1) In general.

(2) Person treated as payee.

(3) Relief from penalties for filing incorrect information return or payee statement.

(f) Statement provided to escrow holder or trustee.

(g) Effective date.

(1) In general.

(2) Transition rule.

(h) Examples.

#### *§1.468B-7 Pre-closing escrows.*

(a) Scope.

(b) Definition.

(c) Taxation of pre-closing escrows.

(d) Reporting obligations of the administrator.

(e) Effective date.

(1) In general.

(2) Transition rule.

(f) Example.

#### *§1.468B-8 Contingent at-closing escrows.*

(a) Scope.

(b) Definitions.

(c) Tax liability of purchaser and seller for the period prior to the determination date.

(d) Transfer of interest in the assets of the escrow on the determination date.

(e) Tax liability of purchaser and seller for the period beginning on the determination date.

(f) Statement required to be provided to administrator within 30 days after the determination date.

(g) Reporting obligations of the administrator.

(1) In general.

(2) Person treated as payee.

(3) Relief from penalties for filing incorrect information return or payee statement.

(h) Effective date.

(1) In general.

(2) Transition rule.

(i) [Reserved]

(j) Example.

#### *§1.468B-9 Disputed ownership funds.*

(a) In general.

(b) Definitions.

(c) Taxation of a disputed ownership fund.

(1) In general.

(2) Exception.

- (3) Special rules.
- (d) Basis of property held by a disputed ownership fund.
- (e) Request for prompt assessment.
- (f) Rules applicable to the transferor.
- (1) Transfer of property.
- (i) In general.
- (ii) Exceptions.
- (2) Economic performance.
- (i) In general.
- (ii) Obligations of the transferor.
- (3) Statement to the disputed ownership fund and the Internal Revenue Service.
- (i) In general.
- (ii) Information required on statement.
- (A) In general.
- (B) Combined statements.
- (4) Distributions to transferors.
- (i) In general.
- (ii) Exception.
- (iii) Deemed distributions.
- (g) Distribution to a claimant other than a transferor.
- (h) Effective date.
- (1) In general.
- (2) Transition rule.
- (i) [Reserved]
- (j) Examples.

Par. 3. Section 1.468B-1 is amended by redesignating paragraph (k) as paragraph (l) and adding a new paragraph (k) to read as follows:

*§1.468B-1 Qualified settlement funds.*

\* \* \* \* \*

(k) *Election to treat a qualified settlement fund as a subpart E trust*—(1) *In general.* If a qualified settlement fund has only one transferor (see paragraph (d)(1) of this section for the definition of transferor), the transferor may make an irrevocable election (grantor trust election) to treat the qualified settlement fund as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder. A grantor trust election may be made whether or not the qualified settlement fund would be classified, in the absence of paragraph (b) of this section, as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder.

(2) *Manner of making grantor trust election*—(i) *In general.* To make a grantor trust election, a transferor must attach an election statement satisfying the

requirements of paragraph (k)(2)(ii) of this section to a timely filed (including extensions) Form 1041 that the administrator files on behalf of the qualified settlement fund for the taxable year in which the qualified settlement fund is established. However, if a Form 1041 would not otherwise be required to be filed (for example, because the provisions of §1.671-4(b) are applicable), then the transferor makes a grantor trust election by attaching an election statement satisfying the requirements of paragraph (k)(2)(ii) of this section to a timely filed (including extensions) income tax return of the transferor for the taxable year in which the qualified settlement fund is established.

(ii) *Requirements for election statement.* The election statement must include a statement by the transferor that the transferor will treat the qualified settlement fund as a grantor trust. The election statement must also include the transferor's name, signature, address, taxpayer identification number, and the legend, "§1.468B-1(k) Election". The election statement and the statement described in §1.671-4(a) may be combined into a single statement.

(3) *Effect of making the election.* If a grantor trust election is made—

(i) Paragraph (b) of this section, and §§1.468B-2, 1.468B-3, and 1.468B-5 do not apply to the qualified settlement fund. However, this section (except for paragraph (b) of this section) and §1.468B-4 apply to the qualified settlement fund;

(ii) The qualified settlement fund is treated for federal income tax purposes as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder;

(iii) The transferor must take into account in computing the transferor's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the qualified settlement fund in accordance with §1.671-3(a)(1); and

(iv) The reporting obligations imposed by §1.671-4 on the trustee of a trust apply to the administrator.

\* \* \* \* \*

Par. 4. Section 1.468B-5 is amended by revising the section heading and adding paragraph (c) to read as follows:

*§1.468B-5 Effective dates and transition rules applicable to qualified settlement funds.*

\* \* \* \* \*

(c) *Grantor trust elections under §1.468B-1(k)*—(1) *In general.* A transferor may make a grantor trust election under §1.468B-1(k) only if the qualified settlement fund is established after the date of publication of final regulations in the *Federal Register*.

(2) *Qualified settlement funds established by the U.S. government on or before the date of publication of final regulations in the Federal Register.* If the U.S. government, or any agency or instrumentality thereof, establishes a qualified settlement fund on or before the date of publication of final regulations in the **Federal Register**, and the fund would have been classified as a trust all of which is treated as owned by the U.S. government under section 671 and the regulations thereunder without regard to the regulations under section 468B, then the U.S. government is deemed to have made a grantor trust election under §1.468B-1(k), and the election is effective for all taxable years of the fund.

Par. 5. Sections 1.468B-6 through 1.468B-9 are added to read as follows:

*§1.468B-6 Qualified escrow accounts and qualified trusts used in deferred exchanges of like-kind property under section 1031(a)(3).*

(a) *Scope.* This section provides rules under section 468B(g) relating to the current taxation of income of a qualified escrow account or qualified trust established in connection with a deferred exchange under section 1031(a)(3).

(b) *Definitions.* As used in this section, *deferred exchange*, *relinquished property*, *replacement property*, *qualified escrow account*, *qualified trust*, *qualified intermediary*, *exchange period*, and *escrow holder* have the same meanings as in §1.1031(k)–. Also, as used in this section, *taxpayer* means the transferor of the relinquished property, and *transferee* means the person who is treated as owning the relinquished property for federal income tax purposes after its transfer by the taxpayer. Further, *owner* means the person treated as owning the assets of the quali-

fied escrow account or qualified trust under paragraph (c) of this section.

(c) *Income of qualified escrow account or qualified trust*—(1) *In general.* Except as otherwise provided in paragraph (c)(2) of this section, and except for purposes of determining whether a transaction qualifies as a deferred exchange, the taxpayer is the owner. Thus, the taxpayer must take into account in computing the taxpayer's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the qualified escrow account or qualified trust.

(2) *Transferee or qualified intermediary has all the beneficial use and enjoyment of assets of a qualified escrow account or qualified trust.* If the transferee or the qualified intermediary has all the beneficial use and enjoyment of assets of a qualified escrow account or qualified trust, the transferee or qualified intermediary is the owner. Thus, the transferee or qualified intermediary must take into account in computing its income tax liability all items of income, deduction, and credit (including capital gains and losses) of the account or trust. The following factors, and other relevant facts and circumstances in a particular case, will be considered in determining whether the transferee or the qualified intermediary, rather than the taxpayer, has the beneficial use and enjoyment of assets of an account or trust and thus is the owner—

(i) Which person enjoys the use of the earnings of the account or trust;

(ii) Which person receives the benefit from appreciation, if any, in the value of the assets of the account or trust; and

(iii) Which person is subject to a risk of loss from a decline, if any, in the value of the assets of the account or trust.

(d) *Application of section 7872.* If the transferee or the qualified intermediary is the owner under paragraph (c)(2) of this section, section 7872 may apply if the deferred exchange involves a below-market loan from the taxpayer to the owner. See section 7872(c)(1) for the loans to which section 7872 applies.

(e) *Reporting obligations of the escrow holder or trustee*—(1) *In general.* The escrow holder of a qualified escrow account and the trustee of a qualified trust must, for each calendar year (or portion thereof) that the account or trust is in existence, report the income of the account or

trust on Forms 1099 in accordance with the information reporting requirements of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code. The Forms 1099 must show the escrow holder or trustee as the payor and must show the proper payee. See paragraph (e)(2) of this section for the determination of the proper payee.

(2) *Person treated as payee.* In satisfying the reporting obligations of paragraph (e)(1) of this section, the following rules apply to the escrow holder of a qualified escrow account and the trustee of a qualified trust—

(i) If no written statement described in paragraph (f) of this section is provided to the escrow holder or trustee, the escrow holder or trustee must treat the taxpayer as the owner and the payee of the income of the account or trust; and

(ii) If a written statement described in paragraph (f) of this section is provided to the escrow holder or trustee, the escrow holder or trustee must treat the person specified on the statement (see paragraph (f)(3) of this section) as the owner and the payee of the income of the account or trust.

(3) *Relief from penalties for filing incorrect information return or payee statement.* For purposes of sections 6721 and 6722, the escrow holder of a qualified escrow account or trustee of a qualified trust will not be treated as failing to file or furnish a correct information return or payee statement solely because, in preparing a Form 1099, the escrow holder or trustee relies on a statement described in paragraph (f) of this section and therefore treats the person specified on the statement (see paragraph (f)(3) of this section) as the owner and the payee of the income of the account or trust. If a statement described in paragraph (f) of this section is not provided to the escrow holder or trustee, the escrow holder or trustee will not be treated as failing to file or furnish a correct information return or payee statement solely because, in preparing a Form 1099, the escrow holder or trustee relies on the absence of the statement and therefore treats the taxpayer as the owner and the payee of the income of the account or trust.

(f) *Statement provided to escrow holder or trustee.* If under paragraph (c)(2) of this section, the qualified intermediary or

transferee is the owner, the taxpayer and the owner must furnish to the escrow holder or trustee a statement that—

(1) Is signed by the taxpayer and the owner;

(2) Is furnished to the escrow holder or trustee within 30 days after the taxpayer transfers the relinquished property; and

(3) Specifies the person treated as the owner and thus as the payee of the income of the account or trust.

(g) *Effective date*—(1) *In general.* This section applies to qualified escrow accounts and qualified trusts established after the date of publication of final regulations in the **Federal Register**.

(2) *Transition rule.* With respect to a qualified escrow account or qualified trust established after August 16, 1986, but on or before the date of publication of final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the account or trust. The Internal Revenue Service will also not challenge a reasonable, consistently applied method for reporting such income.

(h) *Examples.* The provisions of this section may be illustrated by the following examples in which T is the taxpayer, B is the transferee, and QI is the qualified intermediary:

*Example 1.* (i) T uses the calendar year as the taxable year and the cash receipts and disbursements method of accounting. T enters into a deferred exchange agreement with B. Under the agreement, T will transfer property (the relinquished property) to B, and B must transfer to T within the exchange period consideration (cash or replacement property or both) having the same market value as that of the relinquished property. B's obligations under the agreement are secured by the assets of a qualified escrow account. The deferred exchange does not involve the use of a qualified intermediary.

(ii) Under the agreement, B must deposit cash into the qualified escrow account equal to the agreed upon fair market value of the relinquished property on the date the property is transferred to B. The agreement provides that the cash deposited into the escrow account must be invested in a money market fund.

(iii) The agreement provides that B is entitled to receive the interest earned on the escrow account in consideration for B's performance of services in connection with the exchange.

(iv) On September 1, 1999, T transfers the relinquished property to B. The property is unencumbered and has a fair market value of \$100,000 on September 1, 1999. B deposits \$100,000 into a qualified escrow account. The \$100,000 is invested in accordance with the exchange agreement in a



money market fund. During 1999, \$2,000 of interest is earned on the escrow account. During January 2000, an additional \$400 of interest is earned on the escrow account. On February 1, 2000, B uses \$100,000 of the funds in the escrow account to purchase replacement property identified by T, and on this same date B transfers the replacement property to T. The interest earned on the escrow account, \$2,400, is paid to B from the escrow account in consideration for B's performance of services.

(v) Paragraph (c)(1) of this section applies and T must take into account in computing T's income tax liability for 1999 and 2000 the \$2400 of interest earned on the escrow account in those years even though the interest is paid to B as compensation for B's services. Paragraph (c)(1) of this section applies for the following reasons. T, rather than B, enjoys the use of the earnings of the escrow account since the earnings are used to discharge T's obligation to pay B for B's services. B is not considered to have all the beneficial use and enjoyment of the assets of the escrow account merely because the compensation that B is entitled to receive is based on the earnings of the escrow account.

(vi) The escrow holder must file Forms 1099 for 1999 and 2000 and furnish T with payee statements with respect to the interest earned on the escrow in 1999 and 2000. See paragraph (e)(1) of this section.

**Example 2.** (i) The facts are the same as in *Example 1* except that the agreement between B and T requires B to pay \$100,000 to QI; under the agreement between T and QI, QI is obligated to transfer to T within the exchange period consideration (cash or replacement property or both) equal to \$100,000 plus interest thereon at 4 percent compounded semiannually; QI's obligation to transfer this consideration is secured by the \$100,000 received from B, which QI must deposit into a qualified escrow account; the assets of the escrow account must be invested in a money market fund; and, as compensation for QI's performance of services to facilitate the deferred exchange, QI is entitled to receive the excess of the interest earned on the escrow account over the amount of interest (computed at 4 percent compounded semiannually) payable to T in cash or property.

(ii) QI deposits the \$100,000 received from B into a qualified escrow account, and the \$100,000 is invested in a money market fund earning interest at 4.8 percent compounded semiannually. During 1999, \$1,600 of interest is earned on the escrow account. During January 2000, an additional \$400 of interest is earned on the escrow account. On February 1, 2000, QI uses \$101,667 of the funds in the escrow account to purchase replacement property, which is transferred to T. This transfer satisfies QI's obligations under the agreement because \$1,667 is the amount of interest that is earned on \$100,000 at 4 percent compounded semiannually for 5 months. Of the \$2,000 in interest earned on the escrow account in 1999 and 2000, \$1,667 is used to purchase replacement property, and the remaining \$333 is paid in cash to QI as compensation for QI's services.

(iii) Paragraph (c)(1) of this section applies and T must take into account in computing T's income tax liability for 1999 and 2000 the \$2000 of interest earned on the escrow account in those years even though \$333 of the interest is paid to QI as compensation for QI's services.

(iv) The escrow holder must file Forms 1099 and furnish T with payee statements with respect to the \$2000 of interest earned on the escrow in 1999 and 2000. See paragraph (e)(1) of this section.

#### **§1.468B-7 Pre-closing escrows.**

(a) *Scope.* This section provides rules under section 468B(g) for the taxation of income earned on pre-closing escrows.

(b) *Definition.* A *pre-closing escrow* is an escrow account, trust, or fund—

(1) Established in connection with the sale or exchange of real or personal property;

(2) Funded with a down payment, earnest money, or similar payment that is deposited into the escrow prior to the sale or exchange of the property;

(3) Used to secure the obligation of the purchaser to pay the purchase price for the property (in the case of an exchange, *purchaser* means the transferee of the property, and *purchase price* means the required consideration for the property);

(4) The assets of which, including the income earned thereon, will be paid to the purchaser or otherwise distributed for the purchaser's benefit when the property is sold or exchanged (for example, by being distributed to the seller as a credit against the purchase price); and

(5) Which is not a qualified escrow account or qualified trust established in connection with a deferred exchange under section 1031(a)(3).

(c) *Taxation of pre-closing escrows.* The purchaser is treated for federal income tax purposes as owning the assets of a pre-closing escrow. Thus, the purchaser must take into account in computing the purchaser's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the escrow.

(d) *Reporting obligations of the administrator.* For each calendar year (or portion thereof) that a pre-closing escrow is in existence, the escrow agent, escrow holder, trustee, or other person responsible for administering the escrow (the *administrator*) must report the income of the escrow on Forms 1099 in accordance with the information reporting requirements of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code. The Form 1099 must show the administrator as the payor and the purchaser as the payee.

(e) *Effective date*—(1) *In general.* The provisions of this section apply to pre-

closing escrows established after the date of publication of final regulations in the **Federal Register**.

(2) *Transition rule.* With respect to a pre-closing escrow established after August 16, 1986, but on or before the date of publication of final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the escrow. The Internal Revenue Service will also not challenge a reasonable, consistently applied method for reporting such income.

(f) *Example.* The provisions of this section may be illustrated by the following example:

**Example.** P enters into a contract with S for the purchase of residential property owned by S for the price of \$200,000. P is required to deposit \$10,000 of earnest money into an escrow. At closing, the \$10,000 and the interest earned thereon will be credited against the purchase price of the property. The escrow is a pre-closing escrow. P is treated as owning the assets of the escrow, and P is taxable on the interest earned on the escrow prior to closing. The escrow holder must report the income earned on the escrow on Forms 1099 and furnish payee statements to P. The Forms 1099 must show the escrow holder as the payor and P as the payee.

#### **§1.468B-8 Contingent at-closing escrows.**

(a) *Scope.* This section provides rules under section 468B(g) for the taxation of income earned on a contingent at-closing escrow, which is defined in paragraph (b) of this section. No inference should be drawn from this section concerning the tax treatment of a contingent at-closing escrow, or of parties to the escrow, under sections of the Internal Revenue Code other than section 468B. See also paragraph (d) of this section.

(b) *Definitions.* For purposes of this section, the following definitions apply—

*Administrator* means an escrow agent, escrow holder, trustee, or other person responsible for administering an escrow account, trust, or fund (the purchaser or the seller may be the administrator);

*Contingent at-closing escrow* means an escrow account, trust, or fund that satisfies the following requirements—

(1) The escrow is established in connection with the sale or exchange (other than an exchange to which section 354, 355, or 356 applies) of real or personal property used in a trade or business or



held for investment (including stock in a corporation or an interest in a partnership);

(2) Depending on whether events specified in the agreement between the purchaser and the seller that are subject to bona fide contingencies (not including events that are certain, or reasonably certain, to occur, such as the passage of time, or that are certain, or reasonably certain, not to occur) either occur or fail to occur, the escrow's assets (except for assets set aside for taxes or expenses) will be distributable—

- (i) Entirely to the purchaser;
- (ii) Entirely to the seller; or
- (iii) In part, to the purchaser with the remainder to the seller; and

(3) The escrow is not a qualified escrow account or qualified trust established in connection with a deferred exchange under section 1031(a)(3);

*Determination date* means the date on which (or by which) the last of the events subject to a bona fide contingency specified in the agreement between the purchaser and the seller (referred to in the definition of *contingent at-closing escrow*) has either occurred or failed to occur;

*Purchaser* means, in the case of an exchange of property, the transferee of the property; and

*Seller* means, in the case of an exchange of property, the transferor of the property.

(c) *Tax liability of purchaser and seller for the period prior to the determination date.* For the period prior to the determination date, the purchaser is treated as owning the assets of the contingent at-closing escrow for federal income tax purposes. Thus, in computing the purchaser's income tax liability, the purchaser must take into account all items of income, deduction, and credit (including capital gains and losses) of the escrow until the determination date.

(d) *Transfer of interest in the assets of the escrow on the determination date.* No inference should be drawn from this section whether, for purposes of Internal Revenue Code sections other than 468B, there is a transfer of ownership of the assets of a contingent at-closing escrow on the determination date from the purchaser to the seller or from the seller to the purchaser, or the tax consequences of such a transfer. Thus, for example, if there is a

transfer of ownership of the assets of the escrow from the purchaser to the seller on the determination date for purposes of other Code sections, no inference should be drawn from this section whether any portion of the amount transferred is unstated interest. See §1.483-4.

(e) *Tax liability of purchaser and seller for the period beginning on the determination date.* For the period beginning on the determination date, the purchaser and the seller must each take into account in determining their income tax liabilities the income, deductions, and credits (including capital gains and losses) corresponding to their ownership interests in the assets of the escrow.

(f) *Statement required to be provided to administrator within 30 days after the determination date.* Within 30 days after the determination date, the purchaser and the seller must provide the administrator with a written statement that—

- (1) Is signed by the purchaser and the seller;
- (2) Specifies the determination date; and
- (3) Specifies the purchaser's and seller's ownership interests in each asset of the escrow.

(g) *Reporting obligations of the administrator—*(1) *In general.* The administrator of a contingent at-closing escrow must, for each calendar year (or portion thereof) that the escrow is in existence, report the income of the escrow on Forms 1099 in accordance with the information reporting requirements of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code. The Forms 1099 must show as payor the administrator of the escrow and as payee the person (or persons) treated as the payee (or payees) under paragraph (g)(2) of this section.

(2) *Person treated as payee.* In satisfying the reporting obligations of paragraph (g)(1) of this section, the following rules apply to the administrator—

(i) For the period prior to the determination date, the administrator must treat the purchaser as the payee of the income of the escrow;

(ii) For the period beginning on the determination date, if the written statement described in paragraph (f) of this section is timely provided to the administrator, the administrator must treat as the payee (or payees) of the income of the escrow

the purchaser or seller (or both) in accordance with their respective ownership interests as shown on the statement; and

(iii) If the written statement described in paragraph (f) of this section is not provided to the administrator, the administrator must continue to treat the purchaser as the payee of the income of the escrow.

(3) *Relief from penalties for filing incorrect information return or payee statement.* For purposes of sections 6721 and 6722, the administrator will not be treated as failing to file or furnish a correct information return or payee statement solely because, in preparing a Form 1099, the administrator relies on a statement described in paragraph (f) of this section and therefore treats the purchaser or seller (or both) as the payee (or payees) of the income of the escrow in accordance with their respective ownership interests in the assets of the escrow as shown on the statement. If a statement described in paragraph (f) of this section is not provided to the administrator, the administrator will not be treated as failing to file or furnish a correct information return or payee statement solely because, in preparing a Form 1099, the administrator relies on the absence of the statement and therefore treats the purchaser as the payee.

(h) *Effective date—*(1) *In general.* The provisions of this section apply to contingent at-closing escrows that are established after the date of publication of final regulations in the **Federal Register**.

(2) *Transition rule.* With respect to a contingent at-closing escrow established after August 16, 1986, but on or before the date of publication of final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the escrow. The Internal Revenue Service will also not challenge a reasonable, consistently applied method for reporting such income.

(i) [Reserved]

(j) *Example.* The provisions of this section may be illustrated by the following example:

*Example.* (i) P and S are corporations. In 1999, P enters into a contract with S for the purchase of rental real estate. On October 1, 1999, the date of sale, S transfers the real estate to P, and P pays S a portion of the purchase price, \$9,000,000. P deposits the remaining portion of the purchase price, \$850,000, into an escrow account as required by the contract. H is the escrow holder.

(ii) The contract provides that the escrow balance as of November 1, 2000, is payable entirely to P, entirely to S, or partially to P and partially to S depending on the amount, if any, by which the average rental income from the real estate during a specified testing period ending on September 30, 2000, exceeds one or more specified earnings targets.

(iii) According to the terms of the contract, the income earned on the escrow must be accumulated and is not currently distributable to P or S during the period prior to November 1, 2000.

(iv) During the testing period specified in the contract between P and S, the average rental income earned on the property exceeds one (but not all) of the specified earnings targets. As a result, on September 30, 2000, the end of the testing period, P became entitled to 40% of the escrow assets and S became entitled to 60% of the escrow assets.

(v) On October 30, 2000, P and S provide H with the written statement described in paragraph (f) of this section. The written statement is thus provided within 30 days of September 30, 2000. The statement indicates that P's ownership interest in each asset of the escrow is 40 percent and S's ownership interest in each asset is 60 percent.

(vi) The escrow is a contingent at-closing escrow. September 30, 2000, is the determination date because this is the date on which the testing period ends. As of this date, all contingencies specified in the contract are resolved.

(vii) P must take into account all of the income, deductions, and credits (including capital gains and losses) of the escrow in computing P's income tax liability for the period prior to September 30, 2000. See paragraph (c) of this section.

(viii) For the period beginning on September 30, 2000, P must take into account in computing P's income tax liability 40 percent of each item of income, deduction, and credit of the escrow (including capital gains and losses), and S must take into account in computing S's income tax liability 60 percent of these items. See paragraph (e) of this section.

(ix) H is subject to the information reporting requirements of paragraph (g)(1) of this section. H must file Forms 1099 and furnish payee statements to reflect the fact that prior to September 30, 2000, P is the payee of all the income of the escrow, and for the period beginning on September 30, 2000, P is the payee of 40 percent of the income, and S is the payee of 60 percent of the income.

#### *§1.468B-9 Disputed ownership funds.*

(a) *In general.* An escrow account, trust, or fund that is not a qualified settlement fund is a disputed ownership fund if—

(1) It is established to hold money or property subject to conflicting claims of ownership;

(2) The escrow account, trust, or fund is subject to the continuing jurisdiction of a court; and

(3) Money or property cannot be paid or distributed from the escrow account, trust, or fund to, or on behalf of, a

claimant or a transferor without the approval of the court.

(b) *Definitions.* For purposes of this section—

(1) *Administrator* means the person designated as such by the court having jurisdiction over a disputed ownership fund. If no person is designated, the administrator is the escrow agent, escrow holder, trustee, receiver, or other person responsible for administering the fund;

(2) *Claimant* means a person, including a transferor, who claims ownership of, or a legal or equitable interest in, money or property held by a disputed ownership fund;

(3) *Court* means a court of law or equity of the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof;

(4) *Related person* means any person who is related to the transferor within the meaning of section 267(b) or 707(b)(1);

(5) *Transferor* means, in general, a person that transfers to a disputed ownership fund money or property that is subject to conflicting claims of claimants. However, a payor of interest or other income earned by a disputed ownership fund is not a transferor (unless the payor is also a claimant). A transferor may also be a claimant.

(c) *Taxation of a disputed ownership fund—*(1) *In general.* For federal income tax purposes, a disputed ownership fund is treated as the owner of all assets that it holds. A disputed ownership fund is treated as a C corporation for purposes of subtitle F of the Internal Revenue Code, and the administrator of the fund must obtain an employer identification number for the fund, make all required income tax and information returns, and deposit all payments of tax. Also, except as otherwise provided in this section, a disputed ownership fund is taxable as if it were either—

(i) A qualified settlement fund under §1.468B-2 if all the assets transferred to the fund by or on behalf of transferors are passive investment assets, for example, cash or cash equivalents, stock, and debt obligations; or

(ii) A C corporation in all other cases.

(2) *Exception.* If there is a more appropriate method of taxing a disputed owner-

ship fund than as provided in paragraph (c)(1) of this section, the claimants to the fund may submit a private letter ruling request proposing an alternative method of taxation.

(3) *Special rules.* (i) In general, money or property subject to conflicting claims of claimants (disputed property) that is transferred to a disputed ownership fund by, or on behalf of, a transferor is excluded from the gross income of the fund. However, this exclusion does not apply to income earned on assets of the fund such as—

(A) Payments to a disputed ownership fund made in compensation for late or delayed transfers of money or property;

(B) Dividends on stock of a transferor (or a related person) held by the fund; and

(C) Interest on debt of a transferor (or a related person) held by the fund.

(ii) A distribution to a claimant of disputed property by a disputed ownership fund is not a taxable event to the fund.

(iii) A disputed ownership fund is not allowed a deduction for a distribution of disputed property to, or on behalf of, a transferor or a claimant.

(iv) Upon the termination of a disputed ownership fund, if the fund has an unused net operating loss carryover under section 172, an unused capital loss carryover under section 1212, or an unused tax credit carryover, or if the fund has, for its last taxable year, deductions in excess of gross income, the claimant to whom the fund's net assets are distributable will succeed to and take into account the fund's unused net operating loss carryover, unused capital loss carryover, unused tax credit carryover, or excess of deductions over gross income for the last taxable year of the fund. If the fund's net assets are distributable to more than one claimant, the unused net operating loss carryover, unused capital loss carryover, unused tax credit carryover, or excess of deductions over gross income for the last taxable year must be allocated among the claimants in proportion to the value of the assets distributable to each claimant from the fund.

(v) In the case of a disputed ownership fund taxable as if it were a C corporation under paragraph (c)(1)(ii) of this section, this section does not, in general, restrict the fund's use of an otherwise allowable method of accounting or taxable year.

(vi) Appropriate adjustments must be made by a disputed ownership fund or transferors to the fund to prevent the fund and the transferors from taking into account the same item of income, deduction, gain, loss, or credit more than once or from omitting such items.

(d) *Basis of property held by a disputed ownership fund.* In general, the initial basis of property transferred by, or on behalf of, a transferor to a disputed ownership fund is the fair market value of the property on the date of transfer to the fund as determined by the transferor for purposes of the rules in paragraph (f)(1)(i) of this section. However, if paragraph (f)(1)(ii) of this section applies, the fund's initial basis in the property is the same as the basis of the transferor immediately before the transfer to the fund.

(e) *Request for prompt assessment.* A disputed ownership fund is eligible to request the prompt assessment of tax under section 6501(d). For purposes of section 6501(d), a disputed ownership fund is treated as dissolving on the date the fund no longer has any assets (other than a reasonable reserve for potential tax liabilities and related professional fees) and will not receive any more transfers.

(f) *Rules applicable to the transferor—*  
(1) *Transfer of property—(i) In general.* A transferor must treat a transfer of property to a disputed ownership fund as a sale or other disposition of that property for purposes of section 1001(a). In computing the gain or loss, the amount realized by the transferor is the fair market value of the property on the date the transfer is made to the disputed ownership fund.

(ii) *Exceptions.* A transfer of property to a disputed ownership fund is not a sale or other disposition of the property for purposes of section 1001(a) if—

(A) The transferor claims ownership of the transferred property immediately before and immediately after the transfer to the fund; or

(B) The transferor is an agent, fiduciary, or other person acting in a similar capacity acting on behalf of a person claiming ownership of the transferred property immediately before and immediately after the transfer to the fund.

(2) *Economic performance—(i) In general.* For purposes of section 461(h), if a transferor has a liability to one or more claimants for which economic perfor-

mance would otherwise occur under §1.461-4(g) when the transferor makes a payment to the claimant or claimants, economic performance occurs with respect to the liability to the extent the transferor makes a transfer to a disputed ownership fund to resolve or satisfy that liability, but only if the transferor and related persons are not claimants and have no right to receive payments or distributions from the fund.

(ii) *Obligations of the transferor.* With respect to a transferor described in paragraph (f)(2)(i) of this section, economic performance does not occur when the transferor transfers to a disputed ownership fund its debt (or the debt of a related person). Instead, economic performance occurs as the transferor (or related person) makes principal payments on the debt. Similarly, economic performance does not occur when the transferor transfers to a disputed ownership fund its obligation (or the obligation of a related person) to provide property in the future or to make a payment described in §1.461-4(g). Instead, economic performance occurs with respect to such an obligation as property or payments are provided or made to the disputed ownership fund or a claimant.

(3) *Statement to the disputed ownership fund and the Internal Revenue Service—*  
(i) *In general.* By February 15 of the year following each calendar year in which a transferor (or other person acting on behalf of a transferor) makes a transfer to a disputed ownership fund, the transferor (or other person) must provide a statement to the administrator of the fund setting forth the information described in paragraph (f)(3)(ii) of this section. The transferor must attach a copy of the statement to (and as part of) its timely filed income tax return (including extensions) for the taxable year of the transferor in which the transfer is made.

(ii) *Information required on statement—(A) In general.* The statement required by paragraph (f)(3)(i) of this section must include the following information—

(1) A legend, “§1.468B-9(f) Statement”, at the top of the first page;

(2) The transferor's name, address, and taxpayer identification number;

(3) The disputed ownership fund's name, address, and employer identification number;

(4) The date of each transfer;

(5) The amount of cash transferred;

(6) A description of property transferred, the disputed ownership fund's basis in the property as provided in paragraph (d) of this section, and, if the rules of paragraph (f)(1)(ii) of this section apply, the fund's holding period on the date of transfer; and

(7) Whether or not the transferor is also a claimant.

(B) *Combined statements.* If a disputed ownership fund has more than one transferor, any two or more of the transferors may provide a combined statement to the administrator that does not identify the amount of cash or the property transferred by a particular transferor. If a combined statement is used, however, each transferor must include with its copy of the statement that is attached to its income tax return a schedule describing each asset that the transferor transferred to the disputed ownership fund.

(4) *Distributions to transferors—(i) In general.* A transferor must include in gross income any distribution to a transferor (including a deemed distribution described in paragraph (f)(4)(iii) of this section) from a disputed ownership fund. If property is distributed, the amount includible in gross income and the basis in that property is generally the fair market value of the property on the date of distribution.

(ii) *Exception.* The gross income of a transferor does not include a distribution to the transferor of property from a disputed ownership fund if the transferor previously transferred the property to the fund and paragraph (f)(1)(ii) of this section applied to that transfer. Also, the transferor's gross income does not include a distribution of money from the disputed ownership fund equal to the net income earned on that property while it was held by the fund. Further, the transferor's basis in the property is the same as the disputed ownership fund's basis in the property immediately before the distribution to the transferor.

(iii) *Deemed distributions.* If a disputed ownership fund makes a distribution on behalf of a transferor to a person that is not a claimant, the distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to have made a payment to the actual recipient.



(g) *Distribution to a claimant other than a transferor.* Whether a claimant other than a transferor must include in gross income a distribution of money or property from a disputed ownership fund is generally determined by reference to the claim in respect of which the distribution is made. If a disputed ownership fund distributes property to a claimant other than a transferor in satisfaction of the claimant's claim of ownership to that property, the claimant's basis in the property must be adjusted to reflect the adjustments to the basis of the property required under section 1016 for the period the property was held by the fund.

(h) *Effective date*—(1) *In general.* This section applies to disputed ownership funds established after the date of publication of final regulations in the **Federal Register**.

(2) *Transition rule.* With respect to a disputed ownership fund established after August 16, 1986, but on or before the date of publication of final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the fund, transfers to the fund, and distributions made by the fund.

(i) **[Reserved].**

(j) *Examples.* The following examples illustrate the rules of this section:

*Example 1.* (i) Prior to A's death, A was the insured under a life insurance contract (policy) issued by X, an insurance company. A's current spouse and A's former spouse each claim to be the beneficiary under the policy and thus entitled to the policy proceeds (\$1 million). In 1999, X files an interpleader action and deposits the policy proceeds into the registry of the court. On June 1, 2000, a final determination is made that A's current spouse is the beneficiary under the policy and thus entitled to the funds held in the registry of the court. These funds are distributed to A's current spouse.

(ii) The funds held in the registry of the court consisting of the policy proceeds and the earnings thereon are a disputed ownership fund taxable as if it were a qualified settlement fund. See paragraph (c)(1)(i) of this section. The fund's gross income does not include the \$1 million transferred to the fund by X.

*Example 2.* (i) Two unrelated individuals, A and B, claim ownership of certain rental property. A claims to have purchased the property from B's father. However, B asserts that the purported sale to A was ineffective and that B acquired ownership of the property through intestate succession upon the death of B's father. For several years, A has maintained the property and received the rent from the property.

(ii) Pending the resolution of the title dispute between A and B, the title to the property is transferred into a court-supervised escrow on February 1, 2000. Also, on that date the court appoints R as receiver for the property. R collects the rent earned on the property and hires employees necessary for the maintenance of the property. The rents paid to R cannot be distributed to A or B without the court's approval.

(iii) On June 1, 2001, the court makes a final determination that the rental property is owned by B. The court orders B to refund to A the purchase price paid by A to B's father plus interest on that amount from February 1, 2000. Also, the court orders that a distribution be made to B of all funds held in the court registry consisting of the rent collected by R and the income earned thereon. In addition, title to the property is returned to B.

(iv) The rental property and the funds held by the court registry are held in a disputed ownership fund.

(v) A is the transferor to the fund. A does not realize gain or loss under section 1001(a) on A's transfer of the property to the disputed ownership fund.

(vi) The fund is taxable as if it were a C corporation because the rental property is not a passive investment asset. See paragraph (c)(1)(ii) of this section. The fund is not taxable upon receipt of the property. The fund's initial basis in the property is the same as A's adjusted basis immediately before the transfer to the fund. The fund's gross income includes the rents paid to R and the income earned thereon. For the period between February 1, 2000, and June 1, 2001, the fund may be allowed deductions for depreciation and for the costs of maintenance of the property because the fund is treated as owning the property during this period. See sections 162, 167, and 168.

(vii) The fund is not allowed a deduction for the distribution to B of the rent earned on the property while held by the fund (or the income earned thereon). No tax consequences to the fund result from this distribution or from the fund's transfer of the rental property to B pursuant to the court's determination that B owns the property.

Par. 6. Section 1.1031(k)-1 is amended by adding a sentence at the end of paragraphs (g)(3)(i) and (h)(2) to read as follows:

*§1.1031(k)-1 Treatment of deferred exchanges.*

\* \* \* \* \*

(g) \* \* \*

(3) \* \* \* (i) \* \* \* For rules under section 468B(g) relating to the current taxation of income of a qualified escrow account or qualified trust, see §1.468B-6.

\* \* \* \* \*

(h) \* \* \*

(2) \* \* \* For rules under section 468B(g) relating to the current taxation of

income of a qualified escrow account or qualified trust, see §1.468B-6.

\* \* \* \* \*

Michael P. Dolan,  
Deputy Commissioner of  
Internal Revenue.

(Filed by the Office of the Federal Register on January 29, 1999, 8:45 a.m., and published in the issue of the Federal Register for February 1, 1999, 64 F.R. 4801)

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Deduction for Interest on Qualified Education Loans

**REG-116826-97**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and requests to videoconference the public hearing.

SUMMARY: This document contains proposed regulations relating to the deduction for interest paid on qualified education loans. The proposed regulations reflect changes to the law made by the Taxpayer Relief Act of 1997, the Internal Revenue Service Restructuring and Reform Act of 1998, and the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999. The proposed regulations affect taxpayers who pay interest on qualified education loans. This document also provides notice that a public hearing will be held on the proposed regulations and that persons outside the Washington, DC, area who wish to testify at the hearing may request that the IRS videoconference the hearing to their sites.

DATES: Written or electronically generated comments must be received by April 21, 1999. Requests to videoconference the hearing to other sites must be received by March 22, 1999.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG-116826-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be

hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-116826-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). The IRS will publish the time and date of the public hearing and the locations of any video-conferencing sites in an announcement in the **Federal Register**.

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations, contact John P. Moriarty, (202) 622-4950 (not a toll-free number); concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, contact Michael L. Slaughter (202) 622-7190 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION

##### *Background*

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1). Section 202 of the Taxpayer Relief Act of 1997 (Public Law 105-34 (111 Stat. 778) (TRA 97)) added section 221 of the Internal Revenue Code to allow a deduction from gross income for certain interest paid on qualified education loans. On November 17, 1997, the IRS published Notice 97-60 (1997-46 I.R.B. 8) to provide guidance on the higher education tax incentives enacted by TRA 97, including the deduction for interest paid on qualified education loans. Section 6004(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206 (112 Stat. 685)) (RRA 98) and section 4003(a) of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (Public Law 105-277 (112 Stat. 2681)) (Omnibus Act 99) made technical amendments to section 221. TRA 97 also added section 6050S to the Internal Revenue Code, which requires the filing of information returns by certain persons who receive payments of interest that may be deductible as interest on a qualified ed-

ucation loan. In 1998, the IRS published two notices describing the information returns that are required under section 6050S for 1998 and 1999. On January 20, 1998, the IRS published Notice 98-7 (1998-3 I.R.B. 54), which describes the information reporting required under section 6050S for 1998. On November 16, 1998, the IRS published Notice 98-54 (1998-46 I.R.B. 25), which modified Notice 98-7 to reflect a technical amendment made by RRA 98 and extended the application of Notice 98-7, as so modified, to information reporting required under section 6050S for 1999.

##### *Explanation of Provisions*

Section 221 allows taxpayers who are legally obligated to pay interest on qualified education loans a federal income tax deduction for their interest payments. The deduction is an adjustment to gross income and, therefore, is available to eligible taxpayers regardless of whether they itemize deductions. The deduction is limited to \$2,500 for taxable years beginning after 2000. For taxable years 1998, 1999 and 2000, the limits are \$1,000, \$1,500 and \$2,000, respectively. Consistent with the income limitations in section 221(b)(2), the proposed regulations provide that the deduction is phased-out for taxpayers with modified adjusted gross income between \$40,000 and \$55,000 (\$60,000 and \$75,000 for taxpayers filing a joint return) for the taxable year. For taxable years beginning after 2002, these amounts will be adjusted for inflation.

No deduction under section 221 is allowed in a taxable year to an individual who is properly claimed as a dependent on another taxpayer's federal income tax return for the taxable year. In addition, a taxpayer who is married as of the end of a taxable year is allowed a deduction under section 221 only if the taxpayer and the taxpayer's spouse file a joint return for the taxable year.

Consistent with section 221(e)(1), the proposed regulations define a *qualified education loan* to mean any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses on behalf of a student enrolled at least half-time in a program leading to a degree, certificate, or other recognized educational credential. The student must be the

taxpayer, the taxpayer's spouse, or the taxpayer's dependent at the time the indebtedness is incurred. In addition, the qualified higher education expenses must be incurred within a reasonable period of time before or after the indebtedness is incurred. The requirement that the indebtedness be incurred solely to pay qualified higher education expenses was added by RRA '98. Accordingly, *mixed use* loans are not qualified education loans. Similarly, revolving lines of credit (e.g., credit card debt) generally are not qualified education loans, unless the borrower uses the line of credit solely to pay qualified higher education expenses.

Consistent with section 221(e)(1), the proposed regulations provide that a loan made by an individual who is related to the borrower, within the meaning of section 267(b) or 707(b)(1), is not a qualified education loan. For example, a loan from a parent or grandparent of the borrower is not a qualified education loan. In addition, consistent with a technical amendment to section 221(e) contained in the Omnibus Act '99, the proposed regulations provide that loans made under any qualified employer plan (within the meaning of section 72(p)(4)) or made pursuant to any contract referred to in section 72(p)(5) are not qualified education loans. The proposed regulations also provide that loans that are not issued or guaranteed as part of a federal postsecondary education loan program nonetheless may be qualified education loans.

The proposed regulations provide that whether or not qualified higher education expenses are paid within a reasonable period of time before or after the indebtedness is incurred depends on all the facts and circumstances. However, the proposed regulations provide two safe harbors. The first safe harbor treats any education loan that is issued as part of a federal postsecondary education loan program as meeting the reasonable period requirement. The second safe harbor treats qualified higher education expenses as paid or incurred within a reasonable period of time before or after the indebtedness is incurred if the expenses relate to a particular academic period and the proceeds of the loan are disbursed within a period that begins 60 days prior to the start of that academic period and ends 60 days after the end of that academic pe-

riod. The proposed regulations do not require actual tracing of loan proceeds to the payment of qualified higher education expenses.

The proposed regulations define an *eligible educational institution* by reference to section 25A to mean any college, university, vocational school, or other postsecondary educational institution that is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) as in effect on August 5, 1997, and certified by the U.S. Department of Education to be eligible to participate in a student aid program administered by that department. This category includes generally all accredited public, nonprofit, and proprietary postsecondary institutions. Consistent with section 221(e)(2), the proposed regulations provide that, for purposes of the qualified education loan interest deduction, eligible educational institutions also include institutions that conduct an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility that offers postgraduate training.

Qualified higher education expenses are generally the same as the cost of attendance as determined by the eligible educational institution for purposes of calculating a student's financial need, in accordance with section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087II, as in effect on August 4, 1997. Such expenses generally include tuition, fees, room, board, books, equipment, and other necessary expenses, such as transportation. However, for purposes of calculating qualified higher education expenses, the amount of such expenses must be reduced by educational assistance that the student receives and excludes from gross income under section 117 (qualified scholarships), section 127 (employer-provided educational assistance), section 135 (redemption of U.S. savings bonds), and section 530 (distributions from education IRAs). In addition, such expenses must be reduced by a veterans' or member of the armed forces' educational assistance allowance under chapter 30, 31, 32, 34 or 35 of title 38 United States Code, or under chapter 1606 of title 10, United States Code, and any other educational assistance that is excludable from the student's gross income (other than as a gift, be-

quest, devise or inheritance within the meaning of section 102(a)).

The qualified education loan interest deduction generally is available only for interest payments made during the first 60 months in which interest payments are required on the qualified education loan. The proposed regulations provide that the 60-month period commences with the month in which a loan first enters mandatory repayment status and continues to elapse regardless of whether payments are actually made, unless the repayment period is suspended for a period of deferment or forbearance. The 60-month period may expire at different times for different loans of the same borrower.

The date on which a qualified education loan enters repayment status is determined by reference to the loan agreement or the federal regulations governing the applicable federal postsecondary education loan program.

The proposed regulations provide that a deduction is allowed for a payment of interest that was required to be made in one month but that actually is made in a subsequent month prior to the expiration of the 60-month period. A deduction is not allowed for a payment of interest that was required to be made in one month but that actually is made in a subsequent month after the expiration of the 60-month period.

The proposed regulations provide that a qualified education loan and all refinancings of that loan are treated as a single loan for purposes of calculating the 60-month period.

Consistent with section 221(d), as amended by RRA '98, the proposed regulations provide special rules for calculating the 60-month period for consolidated loans or collapsed loans. These rules generally mirror the guidance contained in Notice 98-7 and provide that the 60-month period begins on the most recent date on which any of the underlying loans entered repayment status. See Conf. Rep. No. 599, 105th Cong., 2d Sess., at 339 (1998).

If a qualified education loan entered repayment status prior to January 1, 1998 (the effective date of section 221), the taxpayer is not entitled to deduct any interest paid during that portion of the 60-month period occurring prior to January 1, 1998. A deduction is allowed only for interest due and paid during that portion, if any, of

the 60-month period remaining after December 31, 1997.

General tax principles apply in determining what is deductible interest for purposes of section 221. However, to assist taxpayers, the proposed regulations specifically provide that loan origination fees and capitalized interest are *interest* and are deductible under section 221 as the stated principal amount of the qualified education loan is repaid.

#### *Proposed Effective Date*

These regulations are proposed to be effective for interest paid after the date they are published in the **Federal Register** as final regulations. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

#### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### *Comments and Requests for a Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and on how they can be made easier to understand. All comments will be available for public inspection and copying.



A public hearing will be scheduled in the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. The IRS recognizes that persons outside the Washington, DC, area may also wish to testify at the public hearing through videoconferencing. Requests to include videoconferencing sites must be received by March 22, 1999. If the IRS receives sufficient indications of interest to warrant videoconferencing to a particular city, and if the IRS has videoconferencing facilities available in that city on the date the public hearing is to be scheduled, the IRS will try to accommodate the requests.

The IRS will publish the time and date of the public hearing and the locations of any videoconferencing sites in an announcement in the **Federal Register**.

#### *Drafting Information*

The principal author of these regulations is John P. Moriarty of the Office of the Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

#### *Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### **PART 1—INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.221-1 also issued under 26 U.S.C. 221(d). \* \* \*

Par. 2. Section 1.221-1 is added under the undesignated centerheading "Additional Itemized Deductions For Individuals" to read as follows:

#### *§1.221-1 Deduction for interest on qualified education loans.*

(a) *In general.* An individual taxpayer is allowed a deduction under section 221 from gross income for certain interest paid during the taxable year on a qualified education loan. The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months that interest payments are required under the terms of the loan. See

paragraph (e) of this section for rules relating to the 60-month rule.

(b) *Eligibility*—(1) *Taxpayer must be legally obligated to make interest payments.* A taxpayer is allowed a deduction under section 221 only if the taxpayer is legally obligated to make interest payments under the terms of the qualified education loan.

(2) *Claimed dependents not eligible*—(i) *In general.* An individual is not allowed a deduction under section 221 for a taxable year if the individual is a dependent (as defined in section 152) for whom a deduction under section 151 is claimed on another taxpayer's federal income tax return for the same taxable year (or, in the case of a fiscal year taxpayer, the taxable year beginning in the same calendar year as the individual's taxable year).

(ii) *Examples.* The following examples illustrate the rules of this paragraph (b):

*Example 1. Student not claimed as dependent.* Student A pays \$750 of interest on qualified education loans during 1998. Student A's parents do not claim her as a dependent for 1998. Assuming all other relevant requirements are met, Student A may deduct the \$750 of interest paid in 1998 under section 221.

*Example 2. Student claimed as dependent.* Student B pays \$750 of interest on qualified education loans during 1998. Only Student B is legally obligated to make the payments. Student B's parent claims him as a dependent and a deduction under section 151 is allowed with respect to Student B in computing the parent's 1998 federal income tax. Neither Student B nor Student B's parent may deduct the \$750 of interest paid in 1998 under section 221.

(3) *Married taxpayers.* If a taxpayer is married as of the close of the taxable year, a deduction under this section is allowed only if the taxpayer and the taxpayer's spouse file a joint return for that taxable year.

(c) *Maximum deduction.* In any taxable year, the amount allowed as a deduction under section 221 may not exceed the amount determined in accordance with the following table:

<i>Taxable year beginning in:</i>	<i>Maximum Deduction</i>
1998	\$1,000
1999	\$1,500
2000	\$2,000
2001 and thereafter	\$2,500

(d) *Limitation based on modified ad-*

*justed gross income*—(1) *In general.* The deduction allowed under section 221 is phased out ratably for taxpayers with modified adjusted gross income between \$40,000 and \$55,000 (\$60,000 and \$75,000 for married individuals who file a joint return). Taxpayers with modified adjusted gross income of \$55,000 or above (or \$75,000 or above for joint filers) are not allowed a deduction under section 221.

(2) *Modified adjusted gross income defined.* The term *modified adjusted gross income* means the adjusted gross income (as defined in section 62) of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933 (relating to income earned abroad or from certain U.S. possessions or Puerto Rico). Adjusted gross income must be determined under this section after taking into account the exclusions, deductions and limitations provided for by sections 86 (social security and tier 1 railroad retirement benefits), 135 (redemption of qualified U.S. savings bonds), 137 (adoption assistance programs), 219 (deductible IRA contributions) and 469 (limitation on passive activity losses and credits).

(3) *Inflation adjustment.* For taxable years beginning after 2002, the amounts in paragraph (d)(1) of this section will be increased for inflation occurring after 2001 in accordance with section 1(f)(3). If any amount adjusted under this paragraph (d)(3) is not a multiple of \$5,000, the amount will be rounded to the next lowest multiple of \$5,000.

(e) *60-month rule*—(1) *General rule.* A deduction for interest paid on a qualified education loan is allowed only for payments made during the first 60 months that interest payments are required on the loan. The 60-month period begins on the date the qualified education loan first enters repayment status and ends 60 months later, unless the period is suspended for periods of deferment or forbearance within the meaning of paragraph (e)(3) of this section. The 60-month period continues to elapse regardless of whether the required interest payments are actually made. The date on which the qualified education loan first enters repayment status is determined under the terms of the loan agreement or, in the case of a loan issued or guaranteed under a federal post-



secondary education loan program, under applicable federal regulations. For special rules relating to loan refinancings, consolidated loans, and collapsed loans, see paragraph (h)(1) of this section.

(2) *Loans that entered repayment status prior to January 1, 1998.* In the case of any qualified education loan that entered repayment status prior to January 1, 1998, no deduction is allowed under section 221 for interest paid during the portion of the 60-month period described in paragraph (e)(1) of this section that occurred prior to January 1, 1998. A deduction is allowed only for interest due and paid during that portion, if any, of the 60-month period remaining after December 31, 1997.

(3) *Periods of deferment or forbearance.* The 60-month period described in paragraph (e)(1) of this section is suspended for any period when interest payments are not required on a qualified education loan because the borrower has been granted deferment or forbearance (including postponement in anticipation of cancellation). However, in the case of a qualified education loan that is not issued or guaranteed under a federal postsecondary education loan program, the 60-month period will be suspended under this paragraph (e)(3) only if the borrower satisfies one of the conditions for deferment or forbearance established by the U.S. Department of Education for federal student loan programs under Title IV of the Higher Education Act of 1965, such as half-time study at a postsecondary educational institution, study in an approved graduate fellowship program or in an approved rehabilitation program for the disabled, inability to find full-time employment, economic hardship, or the performance of services in certain occupations or federal programs. The 60-month period is not suspended if, under the terms of the loan—

(i) Interest continues to accrue while the loan is in deferment or forbearance; and

(ii) The taxpayer has the option of paying the interest currently or requesting that the interest be capitalized, and the taxpayer elects to make current interest payments.

(4) *Late payments.* A deduction is allowed for a payment of interest that was required to be made in one month but that actually is made in a subsequent month

prior to the expiration of the 60-month period. A deduction is not allowed for a payment of interest that was required to be made in one month but that actually is made in a subsequent month after the expiration of the 60-month period.

(5) *Examples.* The following examples illustrate the rules of this paragraph (e). In the examples, assume that the institution is an eligible educational institution, the loan is a qualified education loan, and the student is legally obligated to make interest payments under the terms of the loan:

*Example 1. Payment prior to 60-month period.* Student C obtains a loan to attend College V. The terms of the loan provide that interest accrues on the loan while C earns his undergraduate degree but that C is not required to begin making payments of interest until six full calendar months after he graduates. Nevertheless, C voluntarily pays interest on the loan while attending College V. C is not allowed a deduction for interest paid while attending College V because the payments were made during a month prior to the start of the 60-month period.

*Example 2. Deferment option not exercised.* The facts are the same as *Example 1*, except that Student C makes no payments on the loan while C is enrolled at College V. C graduates in June, 1999 and is required to begin making monthly payments of principal and interest on the loan in January, 2000. The 60-month period described in paragraph (e)(1) of this section begins in January, 2000. In August, 2000, C enrolls in graduate school on a full-time basis. Under the terms of the loan, C may apply for deferment of the loan payments while C is enrolled in graduate school. However, C elects not to apply for deferment and continues to make monthly payments on the loan during graduate school. Assuming all other relevant requirements are met, C may deduct interest paid on the loan during the 60-month period beginning in January, 2000, including interest paid while C was enrolled in graduate school, but elected not to defer payment.

*Example 3. Late payment, within 60-month period.* The facts are the same as *Example 2*, except that, after the loan enters repayment status in January, 2000, Student C makes no interest payments until March, 2000. In March, 2000, C pays interest required to be paid for the months of January, February, and March, 2000. Assuming all other relevant requirements are met, C is allowed a deduction for the interest paid in March for the months of January, February, and March because the interest payments were required under the terms of the loan and were paid within the 60-month period, even though the January and February interest payments may be late.

*Example 4. Late payment during deferment but within 60-month period.* The terms of Student D's qualified education loan require her to begin making monthly payments of interest on the loan in January, 2000. The 60-month period described in paragraph (e)(1) of this section begins in January, 2000. D fails to make the required interest payments for the months of November and December, 2000. In January, 2001, D enrolls in graduate school on a half-time basis. Under the terms of the loan, D is eligible

for deferment of the loan payments due while D is enrolled in graduate school. The deferment is granted effective January 1, 2001. In March, 2001, while the loan is in deferment, D pays the interest due for the months of November and December, 2000. Assuming all other relevant requirements are met, D is allowed a deduction for interest paid in March, 2001 for the months of November and December, 2000 because the interest payments were made paid prior to the expiration of the 60-month period, even though the November and December interest payments were late and were made while the loan was in deferment.

*Example 5. 60-month period.* The facts are the same as *Example 4* except that Student D graduates from graduate school in December, 2004 and is required to begin making monthly payments of interest on the loan in June, 2005. As of January, 2001, when the loan entered deferment status, 12 months of the 60-month period had elapsed (January-December, 2000). As of June, 2005, when the loan re-enters repayment status, there are 48 months remaining in the 60-month period for that loan.

*Example 6. 60-month period.* The terms of Student E's qualified education loan require him to begin making monthly payments of interest on the loan in November, 1999. The 60-month period described in paragraph (e)(1) of this section begins in November, 1999. In January, 2000, E enrolls in graduate school on a half-time basis. As permitted under the terms of the loan, E applies for deferment of the loan payments due while E is enrolled in graduate school. While awaiting formal notification from the lender that his request for deferment has been granted, E pays interest due for the month of January, 2000. In February, 2000, E receives notification from the lender that deferment has been granted, effective as January 1, 2000. Assuming all other requirements are met, E is allowed a deduction for interest paid in January, 2000, prior to his receipt of the notification, even though the deferment was granted retroactive to January 1, 2000. As of February, 2000, there are 57 months remaining in the 60-month period for that loan.

*Example 7. Reduction of 60-month period for months prior to January 1, 1998.* The first payment on a qualified education loan is due on January 1, 1997. Thereafter, interest is required to be paid on a monthly basis. The 60-month period for this loan begins on January 1, 1997. However, no deduction is allowed for interest paid by the borrower prior to January 1, 1998, the effective date of section 221. Assuming all other relevant requirements are met, the borrower may deduct interest due and paid on the loan during the 48 months beginning on January 1, 1998 (unless such period is extended for periods of deferment or forbearance under paragraph (e)(3) of this section).

(f) *Definitions—(1) Eligible educational institution.* In general, an eligible educational institution means any college, university, vocational school or other post-secondary educational institution that is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on August 5, 1997, and is certified by the U.S. Department of Ed-

ucation to be eligible to participate in student aid programs administered by the Department, as described in section 25A(f)(2). In addition, for purposes of this section, an eligible educational institution also includes an institution that conducts an internship or residency program leading to a degree or certificate awarded by an institution, a hospital, or a health care facility that offers postgraduate training.

(2) *Qualified higher education expenses*—(i) *In general.* *Qualified higher education expenses* means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on August 4, 1997), at an eligible educational institution, reduced by the amounts described in paragraph (f)(2)(ii) of this section. Consistent with section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, the cost of attendance is determined by the eligible educational institution and includes tuition and fees normally assessed a student carrying the same academic workload, an allowance for room and board, and an allowance for books, supplies, transportation and miscellaneous expenses of the student.

(ii) *Reductions.* Qualified higher education expenses must be reduced by any amount paid to or on behalf of a student with respect to such expenses that is—

(A) A qualified scholarship that is excludable from income under section 117;

(B) A veterans' or member of the armed forces' educational assistance allowance under chapter 30, 31, 32, 34 or 35 of title 38 United States Code, or under chapter 1606 of title 10, United States Code;

(C) Employer-provided educational assistance that is excludable from income under section 127;

(D) Any other educational assistance that is excludable from gross income (other than as a gift, bequest, devise, or inheritance within the meaning of section 102(a));

(E) Any amount excluded from gross income under section 135 (relating to the redemption of United States savings bonds); or

(F) Any amount distributed from an education individual retirement account described in section 530 and excluded from gross income.

(3) *Qualified education loan*—(i) *In general.* Qualified education loan means

indebtedness incurred by a taxpayer solely to pay qualified higher education expenses that are—

(A) Incurred on behalf of a student who is the taxpayer, the taxpayer's spouse, or a dependent (as defined in section 151) of the taxpayer at the time the indebtedness is incurred;

(B) Paid or incurred within a reasonable period of time before or after the indebtedness is incurred. Qualified higher education expenses that are paid with the proceeds of education loans that are part of a federal postsecondary education loan program are deemed to meet this requirement. For other loans, except as provided in paragraph (f)(3)(ii) of this section, what constitutes a reasonable period of time is determined based on all the relevant facts and circumstances; and

(C) Attributable to education provided during an academic period, as described in section 25A and the regulations thereunder, when the student is an eligible student as defined in section 25A(b)(3) (requiring that the student be a degree candidate carrying at least one-half the normal full-time workload).

(ii) *Reasonable period safe harbor.* For purposes of paragraph (f)(3)(i)(B) of this section, qualified higher education expenses are treated as paid or incurred within a reasonable period of time before or after the indebtedness is incurred if the expenses relate to a particular academic period and the loan proceeds are disbursed within a period that begins 60 days prior to the start of that academic period and ends 60 days after the end of that academic period.

(iii) *Related party.* A loan made by a person who is related to the borrower, within the meaning of section 267(b) or 707(b)(1), is not a qualified education loan. For example, a parent or grandparent of the borrower is a related person. In addition, a loan made under any qualified employer plan as defined in section 72(p)(4) or under any contract referred to in section 72(p)(5) is not a qualified education loan.

(iv) *Not federally issued or guaranteed.* A loan does not have to be issued or guaranteed under a federal postsecondary education loan program to be a qualified education loan.

(4) *Examples.* The following exam-

ples illustrate the rules in this paragraph (f):

*Example 1. Eligible educational institution.* University Z is a postsecondary educational institution described in section 481 of the Higher Education Act of 1965. University Z has completed the necessary paperwork and has been certified by the U.S. Department of Education as eligible to participate in federal financial aid programs administered by the Department, although University Z chooses not to participate. University Z is an eligible educational institution.

*Example 2. Qualified education loan.* Student F borrows money from a commercial bank to pay qualified higher education expenses related to his enrollment on a half-time basis in a graduate program at an eligible educational institution. All the loan proceeds are used to pay qualified higher education expenses incurred within a reasonable period of time after the indebtedness is incurred. The loan is not federally guaranteed. The commercial bank is not related to Student F within the meaning of section 267(b) or 707(b)(1). The fact that Student F's loan is not federally issued or guaranteed does not prevent the loan from being a qualified education loan within the meaning of section 221.

*Example 3. Qualified higher education expenses.* Student G receives a \$3,000 qualified scholarship for the 1999 Fall semester, that is excludable from F's gross income under section 117. Student G receives no other forms of financial assistance with respect to the 1999 Fall semester. Student G's cost of attendance for the Fall semester, as determined by Student G's eligible educational institution for purposes of calculating a student's financial need in accordance with section 472 of the Higher Education Act, is \$16,000. For the 1999 Fall semester, Student G has qualified higher education expenses of \$13,000 (the cost of attendance as determined by the institution (\$16,000) reduced by the qualified scholarship proceeds excludable from gross income (\$3,000)).

*Example 4. Qualified education loan.* Student H signs a promissory note for a loan on August 15, 1999, to pay for qualified higher education expenses for the 1999 Fall and 2000 Spring semesters. On August 20, 1999, loan proceeds are disbursed by the lender to Student H's college and credited to H's account to pay qualified higher education expenses for the 1999 Fall semester, that begins on August 23, 1999. On January 25, 2000, additional loan proceeds are disbursed by the lender to Student H's college and credited to H's account to pay qualified higher education expenses for the 2000 Spring semester, that began on January 10, 2000. Student H's qualified higher education expenses for the two semesters are paid within a reasonable period of time, as the first loan disbursement was made within 60 days prior to the start of the Fall 1999 semester and the second loan disbursement was made during the Spring 2000 semester.

*Example 5. Mixed-use loans.* Student I signs a promissory note for a loan which is secured by I's personal residence. Part of the loan proceeds will be used to pay for certain improvements to I's residence and part of the loan proceeds will be used to pay qualified higher education expenses of I's spouse. Because the loan is not incurred by I solely



to pay qualified higher education expenses, the loan is not a qualified education loan.

(g) *Denial of double benefit.* No deduction is allowed under this section for any amount for which a deduction is allowed under another provision of Chapter 1 of the Internal Revenue Code.

(h) *Special rules*—(1) *60-month limitation*—(i) *Refinancing.* A qualified education loan and all refinancings of that loan are treated as a single loan for purposes of calculating the 60-month period described in paragraph (e)(1) of this section.

(ii) *Consolidated loans.* A consolidated loan is a single loan that refinances more than one qualified education loan of a borrower. For consolidated loans, the 60-month period described in paragraph (e)(1) of this section begins on the most recent date on which any of the underlying loans entered repayment status and includes any subsequent month in which the consolidated loan is in repayment status.

(iii) *Collapsed loans.* A collapsed loan is two or more qualified education loans of a single borrower that are treated as a single qualified education loan for loan servicing purposes and are not separately accounted for by the lender or servicer. For a collapsed loan, the 60-month period described in paragraph (e)(1) of this section begins on the most recent date on which any of the underlying loans entered repayment status and includes any subsequent month in which any of the underlying loans is in repayment status.

(2) *Loan origination fees and capitalized interest*—(i) *In general.* Loan origination fees (other than any fees for services) and capitalized interest are interest and are deductible under this section.

(ii) *Capitalized interest defined.* *Capitalized interest* means any accrued and unpaid interest on a qualified education loan that is capitalized by the lender (in accordance with the terms of the loan) and added to the outstanding principal balance of the qualified education loan.

(iii) *Allocation of payments.* Loan origination fees and capitalized interest are deemed to be paid by the taxpayer when principal is repaid on the qualified education loan. Accordingly, the taxpayer may deduct the portion of a stated principal payment that is treated as the payment of any loan origination fees or capitalized interest on the loan. See §§1.446-2(e) and 1.1275-2(a) for rules on how to allo-

cate payments between interest and principal. In general, under these rules, a payment (regardless of its label) is treated first as a payment of interest to the extent of the interest that has accrued and remains unpaid as of the date the payment is due, second as a payment of any loan origination fees or capitalized interest, until such amounts have been reduced to zero, and third as a payment of principal.

(3) *Examples.* The following examples illustrate the rules of this paragraph (h):

*Example 1. Refinancing.* Student J obtains a qualified education loan to pay for an undergraduate degree at an eligible educational institution. After graduation, Student J is required to make monthly interest payments on the loan beginning in January 2000. Student J makes the required interest payments for 15 months. In April 2001, Student J borrows money from another lender to be used exclusively to repay the first qualified education loan. The new loan requires interest payments to start immediately. At the time Student J is required to make interest payments on the new loan there are forty five months remaining of the original 60-month period referred to in paragraph (e)(1) of this section.

*Example 2. Collapsed loans.* To finance his education, Student K obtains four separate qualified education loans from Lender B. The loans enter repayment status on different dates. After all of Student K's loans have entered repayment status, Lender B informs Student K that all four loans will be transferred to Lender C. Following the transfer, Lender C treats the loans as a single loan for loan servicing purposes; Lender C sends Student K a single statement that shows the total principal and interest, and does not keep separate records with respect to each loan. The 60-month period described in paragraph (e)(1) of this section begins on the most recent date on which any of Student K's four loans entered repayment status.

*Example 3. Capitalized interest.* Interest on Student L's qualified education loan accrues while Student L is in school, but Student L is not required to make any payments on the loan until six months after he graduates. At that time, all accrued but unpaid interest is capitalized by the lender and is added to the outstanding principal amount of the loan. Thereafter, Student L is required to make monthly payments of interest and principal on the loan. For purposes of section 221, interest includes both stated interest and capitalized interest. Therefore, in determining the total amount of interest paid on the qualified education loan during the 60-month period described in paragraph (e)(1) of this section, Student L may deduct any principal payments that are treated as payments of capitalized interest under paragraph (h)(4) of this section.

(i) *Effective date.* This section applies to interest due and paid after December 31, 1997, on a qualified education loan.

Robert E. Wenzel,  
Deputy Commissioner of  
Internal Revenue.

(Filed by the Office of the Federal Register on January 20, 1999, 8:45 a.m., and published in the issue of the Federal Register for January 21, 1999, 64 F.R. 3257)

## Notice of Proposed Rulemaking

### Disclosure of Return Information to the Bureau of the Census

REG-121806-97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In T.D. 8811, on page 19, the IRS is issuing temporary regulations relating to additions to, and deletions from, the list of items of information disclosed to the Bureau of the Census for use in certain statistical programs. The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written and electronic comments and requests for a public hearing must be received by February 24, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-121806-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-121806-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at: [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html).

FOR FURTHER INFORMATION CONTACT: Jamie Bernstein, (202) 622-4570 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Background

Under section 6103(j)(1) of the Internal Revenue Code, upon written request

from the Secretary of Commerce, the Secretary is to furnish to the Bureau of the Census ("Bureau") tax return information that is prescribed by Treasury regulations for the purpose of structuring censuses and national economic accounts and conducting related statistical activities. Section 301.6103(j)(1)–1 of the regulations provides an itemized description of the return information authorized to be disclosed for this purpose. Periodically, the disclosure regulations are amended to reflect the changing needs of the Bureau for data for its statutorily authorized statistical activities.

This document contains proposed amendments to the regulations authorizing Internal Revenue Service personnel to disclose additional items of return information that have been requested by the Secretary of Commerce, and to delete certain items of return information that are enumerated in the regulations but that the Secretary of Commerce has indicated are no longer needed.

The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the regulations.

#### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### *Comments and Requests for a Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely

to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulation and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

#### *Drafting Information*

The principal author of these regulations is Douglas Giblen, Office of the Associate Chief Counsel (International) (formerly of the Office of Assistant Chief Counsel (Disclosure Litigation)). However, other personnel from the IRS and Treasury Department participated in their development.

#### *Proposed Amendments to the Regulations*

Accordingly, 26 CFR Part 301 is proposed to be amended as follows:

#### **PART 301—PROCEDURE AND ADMINISTRATION**

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 301.6103(j)(1)–1 also issued under 26 U.S.C. 6103(j)(1); \* \* \*

Par. 2. Section 301.6103(j)(1)–1 is amended by:

1. Revising paragraphs (b)(3) and (b)(6)(i)(A).

2. Adding paragraph (b)(6)(iii).

The revisions and addition read as follows:

*§301.6103(j)(1)–1 Disclosure of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.*

(b) \* \* \*

(3) [The text of this proposed paragraph (b)(3) is the same as the text of §301.6103(j)(1)–1T (b)(3) published in T.D. 8811.]

(6)(i) \* \* \*

(A) [The text of this proposed paragraph (b)(6)(i)(A) is the same as the text of §301.6103(j)(1)–1T(b)(6)(i)(A) published in T.D. 8811.]

(iii) [The text of this proposed paragraph (b)(6)(iii) is the same as the text of §301.6103(j)(1)–1T(b)(6)(iii) published in T.D. 8811.]

Robert E. Wenzel,  
*Deputy Commissioner  
of the Internal Revenue.*

(Filed by the Office of the Federal Register on January 22, 1999, 8:45 a.m., and published in the issue of the Federal Register for January 25, 1999, 64 F.R. 3669)

## **Notice of Proposed Rulemaking and Notice of Public Hearing**

### **Mark-to-Market Accounting for Dealers in Commodities and Traders in Securities or Commodities**

**REG-104924-98**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations for dealers in commodities and traders in securities or commodities regarding the election to use the mark-to-market method of accounting for their businesses. Section 1001(b) of the Taxpayer Relief Act of 1997 amended the applicable tax law for these taxpayers. This document also contains proposed regulations providing guidance on statutory changes to section 475 contained in the Internal Revenue Service Restructuring and Reform Act of 1998 (IRS Restructuring Act). This guidance is necessary because section 7003 of the IRS Restructuring Act generally prohibited the application of mark-to-market accounting to nonfinancial customer paper. Among other things, the proposed regulations provide guidance to taxpayers who are



using mark-to-market accounting for non-financial customer paper. This document also provides notice of a public hearing on these proposed regulations.

**DATES:** Written comments and outlines of topics to be discussed at the public hearing scheduled for June 3, 1999, at 10 a.m. must be received by May 13, 1999.

**ADDRESSES:** Send submissions to CC:DOM:CORP:R (REG-104924-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-104924-98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations about elections by commodities dealers and securities and commodities traders, Jo Lynn Ricks, 202-622-3920; concerning the regulations about nonfinancial customer paper, Pamela Lew, 202-622-3950; concerning submissions and the hearing, Michael L. Slaughter, Jr., 202-622-7190 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### *Paperwork Reduction Act*

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC, 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington,

DC 20224. Comments concerning the collection of information must be received by March 29, 1999.

The first collection of information in this proposed regulation is described in the Explanation of Provisions section of this document (rather than being included in the text of the proposed regulations). That description indicates that the elections under section 475(e)(1) and (f)(1) and (2) may be required to be made on a form to be developed by the IRS. This burden will be reflected on that new form.

The second collection of information in this proposed regulation is in §§1.475(e)-1 and 1.475(f)-2. The information required to be recorded under §§1.475(e)-1 and 1.475(f)-2 is required by the IRS to determine whether an exemption from mark-to-market accounting is properly claimed. This information will be used to make that determination upon audit of taxpayers' books and records. The likely recordkeepers are businesses or other for-profit institutions.

Estimated total annual recordkeeping burden: 1,000 hours.

The estimated annual burden per recordkeeper varies from 15 minutes to 3 hours, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of recordkeepers: 1,000.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

##### *Background*

Section 475 provides that dealers in securities generally must use mark-to-market accounting for all securities. Exceptions from the mark-to-market requirement are generally provided for securities not held for sale to customers and certain securities held as a hedge, provided that the securities are identified as exempt in a proper and timely manner.

For purposes of section 475, a security includes any note, bond, debenture, or other evidence of indebtedness. Revenue Ruling 97-37 (1997-39 I.R.B. 4), clarified that "other evidence of indebtedness" includes customer paper, commonly referred to as trade accounts receivable. The IRS provided procedures for a taxpayer to change its method of accounting for customer paper in Revenue Procedure 97-43 (1997-39 I.R.B. 12).

The IRS Restructuring Act modified the definition of security for purposes of section 475 to exclude nonfinancial customer paper. For this purpose, nonfinancial customer paper is any receivable arising out of the sale of nonfinancial goods or services by a person the principal activity of which is the selling or providing of nonfinancial goods or services if the receivable is held by that person (or a related person) at all times since its issuance. Section 475(c)(4), added by the IRS Restructuring Act, precludes a taxpayer from using mark-to-market accounting under section 475 for nonfinancial customer paper. In addition, the legislative history of the IRS Restructuring Act indicates that taxpayers may not account for nonfinancial customer paper using a mark-to-market or lower-of-cost-or-market method of accounting under other sections of the Code. See H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 353-54 (1998). Congress, however, authorized the Secretary to issue regulations describing situations where taxpayers must use mark-to-market accounting for nonfinancial customer paper in order to prevent taxpayers from using the exclusion in section 475(c)(4) to avoid marking to market receivables that are inventory in the hands of the taxpayer or a related person.

Section 475(e) and (f), added by section 1001(b) of the Taxpayer Relief Act of 1997, allows securities traders and commodities traders and dealers to elect mark-to-market accounting similar to that currently required for securities dealers. These provisions are effective for all taxable years ending after August 5, 1997, the date of enactment of the Taxpayer Relief Act. The proposed regulations clarify several issues relating to these elections, including the identification of securities and commodities as exempt from mark-to-market accounting, the character of marked se-

curities and commodities, and the time and manner for making the elections.

#### *Explanation of Provisions*

##### *Nonfinancial Customer Paper*

Sections 1.446-1(c)(2)(iii), 1.471-12, and 1.475(c)-2(d) of the proposed regulations provide that taxpayers may not use mark-to-market or lower-of-cost-or-market accounting for any nonfinancial customer paper unless a regulation affirmatively provides that the nonfinancial customer paper is to be marked to market as inventory.

The remaining proposed regulations pertaining to section 475(c)(4) are cross references or minor technical changes required by the addition of §1.475(c)-2(d).

##### *Dealers in Commodities*

The proposed regulations generally provide that, except as provided in guidance prescribed by the Commissioner, the rules for mark-to-market accounting for securities dealers apply to commodities dealers that make an election under section 475(e)(1) (electing commodities dealers). Comments are requested whether there are circumstances where the specific rules applicable to securities dealers should not be applied to electing commodities dealers.

Under the proposed regulations, unless the Commissioner otherwise provides in a revenue ruling, revenue procedure, or letter ruling, the exemption from mark-to-market accounting for assets held for investment does not apply to a commodity derivative held by an electing dealer in commodities. If the rule described in the preceding sentence applies (and consequently requires a commodity derivative to be marked to market), the gain or loss is ordinary. The IRS and the Treasury Department believe that it would be extremely rare for a commodity derivative held by a commodities derivative dealer to be acquired other than in a dealer capacity. See §1.475(c)-1(a)(2). Moreover, the IRS and the Treasury Department believe that a dealer in physical commodities generally engages in derivatives activities that are virtually indistinguishable from its dealings in physical commodities. This situation invokes many of the practical concerns that led Congress to

enact section 475(b)(4). The IRS and the Treasury Department welcome comments on whether, and under what circumstances, it may be appropriate for a dealer in physical commodities to identify commodity derivatives as held for investment.

The proposed regulations also provide that, in all cases, if a dealer in commodities identifies a commodity as exempt from mark-to-market accounting under section 475(b)(2), the identification is ineffective unless it is made before the close of the day on which the commodity was acquired, originated, or entered into. Thus, a rule similar to the 30-day identification rule for certain securities in Holding 8 of Rev. Rul. 97-39 (1997-39 I.R.B. 4), does not apply to commodities dealers.

##### *Traders in Securities or Commodities*

The proposed regulations provide that the principles underlying the rules and administrative interpretations applicable to securities dealers also apply to electing traders, unless the proposed regulations or the Commissioner provides otherwise. The IRS and the Treasury Department request comments on whether there are circumstances under which a specific rule applicable to securities dealers should not apply to electing securities traders.

The proposed regulations provide rules for the identification of investment securities as exempt from mark-to-market accounting. The proposed regulations clarify that a trader in securities who elects mark-to-market accounting under section 475(f)(1) for its trading business (an electing trader) must identify, in accordance with section 475(f)(1)(B)(ii), any security held other than in connection with the trading business. If the electing trader is also a dealer in securities, the trader need only identify under section 475(f)(1)(B)(ii) securities that are not held in connection with the trading business and that are also described in section 475(b)(1) (without regard to section 475(b)(2)). That is, the trader need not identify securities that could not properly be identified as being exempt from section 475(a).

The IRS and the Treasury Department believe that in making the section 475 election available to securities traders, Congress did not want taxpayers selectively to mark to market some securities

but selectively to identify other securities as exempt from this treatment. Congress addressed this concern by establishing a higher burden of proof for electing securities traders to identify securities as not subject to section 475 than is applicable to securities dealers. The IRS and the Treasury Department share this concern, particularly because it traditionally has been easier to distinguish investment securities from dealer securities than to distinguish investment securities from trading securities. Accordingly, the proposed regulations provide that in no event is the requirement of section 475(f)(1)(B)(i) satisfied unless the electing trader demonstrates by clear and convincing evidence that a security has no connection to its trading activities. The IRS and Treasury Department request comments on whether any trader of securities could meet this burden and under what circumstances.

In addition, the IRS and the Treasury Department seek comments on the manner in which securities are identified as not held in connection with trading activities and, in particular, comments that focus on the administrability of rules in this area.

Because of the fungible nature of certain securities, the proposed regulations provide a special rule for identifying securities held other than in connection with the electing trader's trading business when the electing trader also trades other of the same or substantially similar securities. In this circumstance, the electing trader does not satisfy section 475(f)(1)(B)(i) unless the security is held in a separate, nontrading account maintained with a third party. The IRS and the Treasury Department are considering extending this special identification rule to all securities, rather than solely to those that are fungible, and request comments on the advisability of doing so.

Under the proposed regulations, all identifications under section 475(f)(1)(B)(ii) must be made on the same day the electing trader acquires, originates, or enters into the security. Thus, a rule similar to the 30-day identification rule for certain securities in Holding 8 of Rev. Rul. 97-39 does not apply to electing traders.

Because the principles of the rules and administrative interpretations applicable to securities dealers apply to electing traders, if an electing trader improperly

identifies as exempt a security that is actually held in connection with that business, the gain or loss with respect to the security is ordinary, and the consequences described in section 475(d)(2) apply to the security (i.e., the security is marked to market and any losses realized with respect to the security prior to its disposition are recognized only to the extent of gain previously recognized with respect to the security). Similarly, under the proposed regulations, if an electing trader fails to identify a security that is not held in connection with its trading business, the consequences of section 475(d)(2) apply to the security, and the gain or loss with respect to the security is ordinary. Moreover, in the event of this failure, the Commissioner may nevertheless treat the security as if the requirements for exemption from mark-to-market accounting were satisfied.

The proposed regulations further provide that the gain or loss with respect to a security that is marked to market under section 475(f)(1)(A) is ordinary. Under this rule, if an electing trader disposes of a security before the close of the taxable year, proposed §1.475(a)–2 applies, and the gain or loss is ordinary income or loss. See sections 475(f)(1)(D) and 475(d)(3) and the legislative history to section 475(f). H.R. Rep. No. 148, 105th Cong., 1st Sess. 445 (1997).

Under the proposed regulations, the above rules for electing securities traders also apply to electing commodities traders. In addition, the proposed regulations provide a special character rule for traders in section 1256 commodity contracts who elect mark-to-market accounting for their businesses. For these traders, the proposed regulations clarify that the capital character rule of section 1256 does not apply to these contracts and, thus, the gain or loss with respect to such contracts is ordinary.

#### *Making the Elections*

The proposed regulations clarify that if a dealer in securities also has a securities or commodities trading business or a commodities dealing business, the dealer may make an election for that business.

The proposed regulations also provide that the mark-to-market elections for dealers in commodities and for traders in

securities or commodities must be made in the time and manner prescribed by the Commissioner. The IRS and the Treasury Department anticipate requiring taxpayers to make the election by filing a form, to be developed by the IRS, not later than 2 months after the beginning of the taxable year for which the election is made. (See the Paperwork Reduction Act section of this preamble, which requests comments on the burden that may be imposed by this requirement.) Interim procedures are being provided in a revenue procedure.

#### *Proposed Effective Dates*

The proposed regulations in §1.475(c)–2(d)(1) apply to every taxpayer who is required by section 475(c)(4) to cease using mark-to-market accounting for nonfinancial customer paper. These regulations are applicable for all taxable years ending after July 22, 1998. Proposed §§1.446–1(c)(2)(iii), 1.471–12, and 1.475(c)–2(d)(2) are applicable for all taxable years ending on or after January 28, 1999. The proposed regulations in §§1.475(e)–1 and 1.475(f)–2 generally apply to securities or commodities acquired on or after March 1, 1999. The rules concerning the time and manner for making the mark-to-market elections for commodities dealers and securities and commodities traders are generally applicable for taxable years ending on or after January 28, 1999.

#### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory impact analysis is not required. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. As previously noted, in those instances where a small entity elects to apply the rules in these regulations, the burden of the collection of information is not significant. Accordingly, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### *Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for June 3, 1999, beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by May 13, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### *Drafting Information*

The principal authors of these regulations are Jo Lynn Ricks and Pamela Lew of the Office of Assistant Chief Counsel (Financial Institutions & Products). However, other personnel from the IRS and the Treasury Department participated in their development.

\* \* \* \* \*



Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §§1.475(a)–3 through 1.475(e)–1 and adding the following entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.475(a)–3 also issued under 26 U.S.C. 475(g).

Section 1.475(b)–1 also issued under 26 U.S.C. 475(b)(4) and 26 U.S.C. 475(g).

Section 1.475(b)–2 also issued under 26 U.S.C. 475(b)(2) and 26 U.S.C. 475(g).

Section 1.475(b)–4 also issued under 26 U.S.C. 475(b)(2), 26 U.S.C. 475(g), and 26 U.S.C. 6001.

Section 1.475(c)–1 also issued under 26 U.S.C. 475(g).

Section 1.475(c)–2 also issued under 26 U.S.C. 475(g) and 26 U.S.C. 860G(e).

Section 1.475(d)–1 also issued under 26 U.S.C. 475(g).

Section 1.475(e)–1 also issued under 26 U.S.C. 475(g).

Section 1.475(f)–1 also issued under 26 U.S.C. 475(g).

Section 1.475(f)–2 also issued under 26 U.S.C. 475(g).\*\*\*

Par. 2. In §1.446–1, paragraph (c)(2)(iii) is added to read as follows:

*§1.446–1 General rule for methods of accounting.*

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iii) Section 475 is the exclusive authority on which a taxpayer may rely to use the mark-to-market method of accounting for nonfinancial customer paper, as defined in section 475(c)(4)(B). Thus, except to the extent provided in §1.475(c)–2(d), the mark-to-market method of accounting is not a permissible method of accounting for nonfinancial customer paper. In addition, the lower-of-cost-or-market method of accounting is not a permissible method of accounting for these assets. See §1.471–12. This paragraph (c)(2)(iii) applies to all tax years ending on or after January 28, 1999.

\* \* \* \* \*

Par. 3. Section 1.471–12 is added as follows:

*§1.471–12 Nonfinancial customer paper.*

Nonfinancial customer paper, as defined in section 475(c)(4)(B), may not be treated as inventory except as provided in §1.475(c)–2(d). This section applies to taxable years ending on or after January 28, 1999.

Par. 4. In §1.475(c)–1, paragraphs (b)(3)(i) and (b)(4)(ii) are revised to read as follows:

*§1.475(c)–1 Definitions—dealer in securities.*

\* \* \* \* \*

(b) \* \* \*

(3) \* \* \*

(i) For purposes of section 471, the taxpayer accounts for any security (as defined in section 475(c)) as inventory;

\* \* \* \* \*

(4) \* \* \*

(ii) *Continued applicability of an election—(A) In general.* Except as provided in paragraph (b)(4)(ii)(B) of this section, an election under this paragraph (b)(4) continues in effect for subsequent taxable years until revoked. The election may be revoked only with the consent of the Commissioner.

(B) *Taxable years ending after July 22, 1998.* An election under this paragraph (b)(4) is ineffective for taxable years ending after July 22, 1998.

\* \* \* \* \*

Par. 5. In §1.475(c)–2, paragraph (d) is added to read as follows:

*§1.475(c)–2 Definitions—security.*

\* \* \* \* \*

(d) *Inventory—(1) Nonfinancial customer paper is generally not marked to market under section 475.* Except as provided in paragraph (d)(3) of this section, nonfinancial customer paper (as defined in section 475(c)(4)(B)) is not a security even if it is inventory.

(2) *Treatment of nonfinancial customer paper under other sections of the Internal Revenue Code.* For nonfinancial customer paper that is not a security, the

mark-to-market method of accounting and the lower-of-cost-or-market method of accounting are not permissible methods of accounting. See §§1.446–1(c)(2)(iii) and 1.471–12.

(3) *Nonfinancial customer paper treated as inventory.* [Reserved].

**§1.475(e)–1 [Redesignated as §1.475(g)–1]**

Par. 6. Section 1.475(e)–1 is redesignated as §1.475(g)–1.

Par. 7. New §1.475(e)–1 and §§1.475(f)–1 and 1.475(f)–2 are added to read as follows:

*§1.475(e)–1 Election of mark-to-market accounting for dealers in commodities.*

(a) *Time and manner of making election.* An election under section 475(e)(1) must be made in the time and manner prescribed by the Commissioner.

(b) *Application of securities dealer rules to electing commodities dealers.* Except as otherwise provided in this section or in other guidance prescribed by the Commissioner, the rules and administrative interpretations under section 475 for dealers in securities apply to dealers in commodities that make an election under section 475(e)(1).

(c) *Commodity derivatives deemed not held for investment—(1) In general.* Except as otherwise determined by the Commissioner in a revenue ruling, revenue procedure, or letter ruling, if a dealer in commodities that made an election under section 475(e)(1) holds a commodity described in section 475(e)(2)(B) or (C) (describing certain notional principal contracts and commodity derivatives), section 475(b)(1)(A) (exempting from mark-to-market accounting certain positions that are held for investment) does not apply to that commodity.

(2) *Character of commodity derivatives required to be marked to market.* If a commodity is required to be marked to market because of the application of paragraph (c)(1) of this section, the gain or loss with respect to that commodity is ordinary.

(d) *Same day identification.* An identification of a commodity as exempt from mark-to-market accounting under section 475(b)(2) is not effective unless it is made before the close of the day on which the



commodity was acquired, originated, or entered into.

*§1.475(f)–1 Procedures for electing mark-to-market accounting for traders.*

(a) *Time and manner of making election.* An election under section 475(f)(1) or (2) must be made in the time and manner prescribed by the Commissioner.

(b) *Coordination with section 475(a).* If a dealer in securities also has a securities or commodities trading business or a commodities dealing business, the dealer may make an election under section 475(e)(1), (f)(1), or (f)(2) for that business.

*§1.475(f)–2 Election of mark-to-market accounting for traders in securities or commodities.*

(a) *Securities not held in connection with trading activities—*(1) *Taxpayer identification of investment securities.* If a trader in securities makes an election under section 475(f)(1)(A) (electing trader) and holds a security other than in connection with that trading business, the electing trader must identify that security in accordance with section 475(f)(1)(B)(ii). If the electing trader is also a dealer in securities, however, the preceding sentence applies only to securities described in section 475(b)(1) (without regard to section 475(b)(2)).

(2) *Satisfaction of Commissioner.* In no event is the requirement of section 475(f)(1)(B)(i) satisfied unless the electing trader demonstrates by clear and convincing evidence that a security has no connection to its trading activities.

(3) *Substantially similar securities held for trading and investment.* An electing trader that holds a security other than in connection with its trading business and also trades the same or substantially similar securities in no event satisfies the requirement of section 475(f)(1)(B)(i) unless the security is held in a separate, nontrading account maintained with a third party.

(4) *Consequences of failure to identify investment securities.* If an electing trader holds a security that is not held in connection with its trading business and fails to identify the security in a manner that satisfies the requirements of section 475(f)(1)(B)(ii)—

(i) The consequences described in sec-

tion 475(d)(2) apply to the security; and

(ii) The character of the gain or loss with respect to the security is ordinary.

(5) *Commissioner identification of investment securities.* Notwithstanding paragraph (a)(4) of this section, the Commissioner may treat a security described in that paragraph as meeting the requirements of section 475(f)(1)(B)(i) and (ii).

(b) *Character of securities marked to market.* The gain or loss with respect to a security that is marked to market under section 475(f)(1)(A) is ordinary.

(c) *Application of securities dealer rules to electing traders.* Except as otherwise provided in this section or in other guidance prescribed by the Commissioner, the principles of the rules and administrative interpretations under section 475 for dealers in securities apply to traders in securities that make an election under section 475(f)(1).

(d) *Same day identification.* An identification of a security as exempt from mark-to-market accounting under section 475(f)(1)(B) is not effective unless it is made before the close of the day on which the security was acquired, originated, or entered into.

(e) *Application to traders in commodities—*(1) *General rule.* If a trader in commodities makes an election under section 475(f)(2), paragraphs (a), (b), (c), and (d) of this section apply to the trader in the same manner that they apply to a trader in securities who makes an election under section 475(f)(1).

(2) *Coordination with section 1256.* If a trader in commodities makes an election under section 475(f)(2) and trades section 1256 contracts that are commodities as defined in section 475(e)(2), then the rules of section 475(f) and paragraph (e)(1) of this section apply to those contracts, and not the capital character rules of section 1256.

Par. 8. Newly designated §1.475(g)–1 is amended by revising paragraphs (h)(2) and (i) and adding paragraphs (k), (l), and (m) to read as follows:

*§1.475(g)–1 Effective dates.*

\* \* \* \* \*

(h) \* \* \*

(2) Section 1.475(c)–1(b) (concerning sellers of nonfinancial goods and services) applies as follows:

(i) Except as otherwise provided in this paragraph (h)(2), §1.475(c)–1(b) applies to taxable years ending on or after December 31, 1993.

(ii) Section 1.475(c)–1(b)(4)(ii)(B) applies to taxable years ending after July 22, 1998.

\* \* \* \* \*

(i) Section 1.475(c)–2 (concerning the definition of security) applies as follows:

(1) Section 1.475(c)–2(a), (b), and (c) (concerning the definition of security) applies to taxable years ending on or after December 31, 1993. By its terms, however, §1.475(c)–2(a)(3) applies only to residual interests or to interests or arrangements acquired on or after January 4, 1995; and the integrated transactions that are referred to in §1.475(c)–2(a)(2) and (b) exist only after August 13, 1996 (the effective date of §1.1275–6).

(2) Section 1.475(c)–2(d) applies as follows:

(i) Section 1.475(c)–2(d)(1) applies to taxable years ending after July 22, 1998.

(ii) Section 1.475(c)–2(d)(2) applies to taxable years ending on or after January 28, 1999.

\* \* \* \* \*

(k) Section 1.475(e)–1(a) (concerning the time and manner for making the mark-to-market election for dealers in commodities) applies to taxable years ending on or after January 28, 1999. Section 1.475(e)–1(b), (c) and (d) applies to commodities acquired on or after March 1, 1999.

(l) Section 1.475(f)–1 (procedures for electing mark-to-market accounting for traders in securities or commodities) applies to taxable years ending on or after January 28, 1999.

(m) Section 1.475(f)–2 (concerning the mark-to-market rules for traders in securities or commodities) applies to securities or commodities acquired on or after March 1, 1999.

Robert E. Wenzel,  
Deputy Commissioner of  
Internal Revenue.

(Filed by the Office of the Federal Register on January 27, 1999, 8:45 a.m., and published in the issue of the Federal Register for January 28, 1999, 64 F.R. 4374)

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Modifications and Additions to the Unified Partnership Audit Procedures

**REG-106564-98**

**AGENCY:** Internal Revenue Service, Treasury.

**ACTION:** Notice of proposed rulemaking, notice of proposed rulemaking by cross-reference to temporary regulations, and notice of public hearing.

**SUMMARY:** In T.D. 8808 on page 21, the Internal Revenue Service (Service) is issuing temporary regulations relating to the unified partnership audit procedures added to the Internal Revenue Code by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The text of those temporary regulations also generally serves as the text of these proposed regulations. This document also provides a notice of public hearing on these proposed regulations.

**DATES:** Written and electronic comments must be received by April 26, 1999. Outlines of topics to be discussed at the public hearing scheduled for April 14, 1999, at 10 a.m. must be received by March 24, 1999.

**ADDRESSES:** Send submissions to: CC:DOM:CORP:R (REG-106564-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-106564-98), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). The public hearing will be held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CON-

TACT: Concerning the proposed and temporary regulations, Robert G. Honigman, (202) 622-3050; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing Michael L. Slaughter, Jr., (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

Temporary and final regulations in T.D. 8808 amend the Procedure and Administration Regulations (26 CFR part 301) relating to the unified partnership audit procedures found in sections 6221 through 6233 of the Internal Revenue Code (Code).

The text of those temporary regulations also generally serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary and proposed regulations.

Temporary regulations previously were published on December 13, 1984 (49 F.R. 48536), and March 5, 1987 (52 F.R. 6779) (the existing regulations). The Service intends to finalize such regulations simultaneously with finalizing these regulations. Comments previously received in connection with the existing regulations will be considered as well as new or additional comments with respect to such regulations.

##### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

##### *Comments and Public Hearing*

Before these proposed regulations are

adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the Service. All comments will be available for public inspection and copying. The Service and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand.

A public hearing has been scheduled for April 14, 1999, at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit electronic or written comments by April 26, 1999, and an outline of the topics to be discussed and the time devoted to each topic (a signed original and eight (8) copies) by March 24, 1999.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

##### *Drafting Information*

The principal authors of these proposed regulations are Robert G. Honigman, Office of the Assistant Chief Counsel (Passthroughs & Special Industries), and William A. Heard, Office of the Assistant Chief Counsel (Field Service). However, other personnel from the Service and Treasury Department participated in their development.

\* \* \* \* \*

*Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

**PART 301—PROCEDURE AND ADMINISTRATION**

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 301.6221-1 as proposed to be added at 51 F.R. 13235, April 18, 1986, is amended by:

1. Redesignating paragraph (c) as paragraph (e);

2. Adding paragraphs (c) and (d).

The additions read as follows:

*§301.6221-1 Tax treatment determined at partnership level.*

\* \* \* \* \*

(c) and (d) [The text of proposed paragraphs (c) and (d) are the same as the text of §301.6221-1T(c) and (d) published in T.D. 8808.]

\* \* \* \* \*

Par. 3. Section 301.6223(c)-1 as proposed to be added at 51 F.R. 13238, April 18, 1986, is amended by adding a sentence at the end of paragraph (c) to read as follows:

*§301.6223(c)-1 Additional information regarding partners furnished to the Service.*

\* \* \* \* \*

(c) \* \* \* [The text of the proposed last sentence in paragraph (c) is the same as the text of the last sentence in §301.6223(c)-1T(c) published in T.D. 8808.]

\* \* \* \* \*

Par. 4. Section 301.6224(c)-3 as proposed to be added at 51 F.R. 13241, April 18, 1986, is amended by revising the section heading and paragraphs (b), (c)(3)(ii) and (d), *Example (1)* to read as follows:

*§301.6224(c)-3 Consistent settlement terms.*

\* \* \* \* \*

(b) [The text of proposed paragraph (b) is the same as the text of §301.6224(c)-3T(b) published in T.D. 8808.]

(c) \* \* \*

(3) \* \* \*

(ii) [The text of proposed paragraph (c)(3)(ii) is the same as the text of §301.6224(c)-3T(c)(3)(ii) published in T.D. 8808.]

(d) \* \* \*

*Example (1).* [The text of proposed paragraph (d) *Example (1)*, is the same as the text of §301.6224(c)-3T(d) *Example (1)*, published in T.D. 8808.]

\* \* \* \* \*

Par. 5. Section 301-6229(b)-2 is added to read as follow:

*§301.6229(b)-2 Special rule with respect to debtors in Title 11 cases.*

[The text of this proposed section is the same as the text of §301.6229(b)-2T published in T.D. 8808.]

Par. 6. Section 301.6229(f)-1 is added to read as follows:

[The text of this proposed section is the same as the text of §301.6229(f)-1T published in T.D. 8808.]

Par. 7. Section 301.6231(a)(1)-1 as proposed to be added at 51 F.R. 13243, April 18, 1986, is amended by:

1. Revising the first two sentences of paragraph (a)(1);

2. Removing paragraph (a)(3);

3. Redesignating paragraph (a)(4) as paragraph (a)(3).

The revision reads as follows:

*§301.6231(a)(1)-1 Exception for small partnerships.*

(a) \* \* \*

(1) [The text of the proposed first two sentences of paragraph (a)(1) is the same as the text of the first two sentences of §301.6231(a)(1)-1T(a)(1) published in T.D. 8808]. \* \* \*

\* \* \* \* \*

Par. 8. Section 301.6231(a)(6)-1 as proposed to be added at 51 F.R. 13245, April 18, 1986, is amended by:

1. Revising paragraph (a);

2. Removing paragraph (c).

The revision reads as follows:

*§301.6231(a)(6)-1 Computational adjustments.*

(a) [The text of proposed paragraph (a) is the same as the text of §301.6231(a)(6)-1T(a) published in T.D. 8808.]

\* \* \* \* \*

Par. 9. Section 301.6231(a)(7)-1 is amended by revising paragraphs (p)(2), (r)(1) and (s) to read as follows:

*§301.6231(a)(7)-1 Designation or selection of tax matters partner.*

\* \* \* \* \*

(p) \* \* \*

(2) *When each general partner is deemed to have no profits interest in the partnership.* If it is impracticable under paragraph (o)(2) of this section to apply the largest-profits-interest rule of paragraph (m)(2) of this section, the Commissioner will select a partner (including a general or limited partner) as the tax matters partner in accordance with the criteria set forth in paragraph (q) of this section. The Commissioner will notify, within 30 days of the selection, the partner selected, the partnership, and all partners required to receive notice under section 6223(a), effective as of the date specified in the notice.

\* \* \* \* \*

(r) \* \* \* (1) *In general.* If the Commissioner selects a tax matters partner under the provisions of paragraph (p)(1) or (3)(i) of this section, the Commissioner will notify, within 30 days of the selection, the partner selected, the partnership, and all partners required to receive notice under section 6223(a), effective as of the date specified in the notice.

\* \* \* \* \*

(s) *Effective date.* This section applies to all designations, selections, and terminations of a tax matters partner occurring on or after December 23, 1996, except for paragraphs (p)(2) and (r)(1), that are applicable on the date they are published as final regulations in the Federal Register.

Robert E. Wenzel,  
Deputy Commissioner of  
Internal Revenue Service.



## Notice of Proposed Rulemaking

### Capital Gains, Installment Sales, Unrecaptured Section 1250 Gain

REG-110524-98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the regulations relating to the taxation of capital gains on installment sales of depreciable real property. The proposed regulations interpret changes made by the Taxpayer Relief Act of 1997, as amended by the Internal Revenue Service Restructuring and Reform Act of 1998 and the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999. The proposed regulations affect persons required to report capital gain from an installment sale where a portion of the capital gain is unrecaptured section 1250 gain and a portion is adjusted net capital gain.

DATES: Written comments or requests for a public hearing must be received by April 22, 1999.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG-110524-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-110524-98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html).

FOR FURTHER INFORMATION CON-

TACT: Concerning the regulations, Susan Kassell, (202) 622-4930; concerning submissions, LaNita VanDyke, (202) 622-7190 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) relating to the taxation of capital gains on installment sales of depreciable real property.

Prior to 1997, the maximum rate on net capital gain for individuals was 28 percent. In the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788, 831) (1997 Act), Congress amended section 1(h) generally to reduce the maximum capital gain tax rates for individuals. Certain substantive changes and technical corrections to section 1(h) were enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685), including the repeal of an 18-month holding period requirement for amounts properly taken into account after December 31, 1997, and by the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999, Public Law 105-277 (112 Stat. 2681).

As amended, section 1(h) generally divides net capital gain into three rate groups based on the nature of the property, the nature of the gain, and the holding period of the property.

A maximum marginal rate of 28 percent applies to 28-percent rate gain (28-percent gain), the combination of (1) capital gains and losses from the sale or exchange of collectibles held for more than one year; (2) an amount equal to gain excluded from income on the sale or exchange of certain small business stock under section 1202; (3) capital gains and losses determined under special transition rules in section 1(h)(13) for certain amounts taken into account in 1997; (4) net short-term capital loss for the tax year; and (5) any long-term capital loss carry-over to the tax year under section 1212.

A maximum marginal rate of 25 percent applies to unrecaptured section 1250 gain (25-percent gain), which is defined in section 1(h)(7)(A) as the amount of long-term capital gain (not otherwise

treated as ordinary income) that would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent, reduced by any net loss in the 28-percent rate category. Effectively, the amount of gain taxed at 25 percent is the amount of straight-line depreciation allowed for the property. Thus, the 25-percent rate category partially recaptures such depreciation, but the recapture is limited, inter alia, in that the recapture rate may be less than the marginal rates that applied to the depreciation deductions. Section 1(h)(7)(B) limits the unrecaptured section 1250 gain from section 1231 assets for any tax year to the net section 1231 gain for that year.

A maximum marginal rate of 20 percent generally applies to adjusted net capital gain (20/10-percent gain), defined in section 1(h)(4) as the portion of net capital gain that is not taxed at the 28-percent or 25-percent rates. Under section 1(h)(1)(B), a 10-percent rate applies to any portion of adjusted net capital gain that would otherwise be taxed at a 15-percent rate if capital gains were taxed as ordinary income.

For amounts properly taken into account after July 28, 1997, and before January 1, 1998, an 18-month holding period is required to obtain the maximum 25-percent, 20-percent, or 10-percent rates.

Section 453 provides that, unless taxpayers elect out, gain from an installment sale is recognized as payments on the installment obligation are received. Before the 1997 Act, reporting capital gain under the installment method was relatively straightforward: the capital gain portion of each payment was taxed at the maximum capital gain rate of 28 percent. Section 1(h) provides for multiple rates, but does not address how to treat an installment sale of depreciable real property when the gain to be reported consists of both 25-percent gain and 20/10-percent gain.

##### *Explanation of Provisions*

##### *Front-Loaded Allocation of Unrecaptured Section 1250 Gain*

Under the proposed regulations, if a portion of the capital gain from an installment sale is 25-percent gain and a portion



is 20/10-percent gain, the taxpayer is required to take the 25-percent gain into account before the 20/10-percent gain, as payments are received. (Because sales that result in 28-percent gain cannot also yield 25-percent gain or 20/10-percent gain, an allocation rule for 28-percent gain is unnecessary.)

A front-loaded allocation method for 25-percent gain is generally consistent with the statute, under which 20/10-percent gain (that is, adjusted net capital gain) is defined as the residual category of capital gain not taxed at maximum rates of 28 percent or 25 percent. The front-loaded method precludes taxpayers from recognizing some 20/10-percent gain from an installment sale even when the amount ultimately recognized proves to be less than the amount subject to recapture at the 25-percent rate. Absent a front-loaded allocation method this inappropriate result could arise, for example, when a taxpayer later disposes of an installment obligation at a discounted price or when the amount to be received is contingent.

The IRS and Treasury Department have previously adopted analogous front-loaded allocation methods with respect to installment sales. For example, before 1984—when Congress enacted section 453(i), which requires immediate recognition of recapture gain at ordinary rates under sections 1245 and 1250—taxpayers were permitted to defer recognition of this ordinary-rate recapture gain under the installment method. Thus, an installment payment could contain both capital gain and gain taxed at ordinary rates. By regulation, a front-loaded allocation of the ordinary-rate recapture gain was required. §§1.1245-6(d); 1.1250-1(c)(6). See *Dunn Construction v. United States*, 323 F. Supp. 440 (N.D. Ala. 1971) (upholding §1.1245-6(d) as “reasonable and consistent with the underlying statute” and a valid exercise of the regulatory authority under section 453). See also §§1.1251-1(e)(6), 1.1252-1(d)(3), 1.1254-1(d), and 16A.1255-1(c)(3).

#### *Interaction with Section 1231*

Section 1(h) also does not address the interaction of the capital gain rates, the installment method, and the rules in section 1231. Section 1231(a) generally provides that, when gains from the sale or exchange of property used in a trade or busi-

ness exceed losses from such property, the gains and losses are treated as long-term capital gains and losses. Conversely, when section 1231 losses exceed section 1231 gains, the gains and losses are treated as ordinary. The capital nature of net section 1231 gain is subject to an exception: under section 1231(c), net section 1231 gain is treated as ordinary income to the extent of the taxpayer’s non-recaptured net section 1231 losses for the preceding five years.

With respect to the interaction of section 1231(c) and the capital gain rates, the IRS and Treasury Department have already provided that section 1231 gain that is recharacterized as ordinary gain under section 1231(c) is deemed to consist first of 28-percent gain, then 25-percent gain, and finally 20/10-percent gain. See Notice 97-59 (1997-45 IRB 7, 8). An example in the proposed regulations illustrates the application of this principle in the installment sale context. Consistent with this treatment and with the general rule that 25-percent gain is front-loaded, another example in the proposed regulations illustrates that—in a year in which installment gain is characterized as ordinary gain under section 1231(a) because there is a net section 1231 loss for the year—the gain is treated as consisting of 25-percent gain first, before 20/10-percent gain, for purposes of determining how much 25-percent gain remains to be taken into account in later payments.

The examples in the proposed regulations—regarding the interaction of sections 1(h), 453, and 1231—are specific applications of the general rule that, for any given installment payment, gain from all previous payments is treated as consisting first of 25-percent gain, rather than 20/10-percent gain, in determining how much of each category of gain remains to be reported with respect to current and subsequent payments. Under the regulations, in making this determination it is generally irrelevant how such prior gain was actually reported and taxed. For example, an installment payment that is taxed at 15 percent because the taxpayer is in a low tax bracket may be treated as consisting of 25-percent gain (that is, unrecaptured section 1250 gain) for allocation purposes, even though the gain is not actually taxed at 25 percent. The proposed regulations focus on examples in-

volving section 1231 since they are the most common.

#### *Treatment of Installment Payments from Sales Prior to the Effective Date of the 1997 Act*

The capital gains provisions of the 1997 Act were effective for taxable years ending after May 6, 1997. However, the maximum rate of 28 percent was not reduced for gains properly taken into account before May 7, 1997. Under settled authority, originating in *Snell v. Commissioner*, 97 F.2d 891 (5th Cir. 1938), the law in effect when an installment payment is received controls the tax treatment of the payment. Unless otherwise provided, installment payments received after a change in the law are taxed under the new law, whether favorable or unfavorable, looking back to the original transaction for the facts necessary to apply the changed law. In *Snell*, for example, installment payments from what was a capital asset in the sale year were taxed as ordinary income after Congress changed the definition of a *capital asset*. See also *Estate of Kearns v. Commissioner*, 73 T.C. 1223 (1980); *Klein v. Commissioner*, 42 T.C. 1000 (1964); Rev. Rul. 79-22 (1979-1 CB 275). Congress also implicitly has recognized the *Snell* principle by enacting grandfather exceptions when the application of *Snell* would be unfavorable. For example, when Congress extended the holding period requirement for capital gain in 1976, the legislation specifically excepted from the new, harsher requirements post-1976 installment gain from pre-1976 sales.

The legislative history of the 1997 Act reflects the *Snell* principle, providing that section 1(h) “generally applies to sales and exchanges (and installment payments received) after May 6, 1997.” Conf. Rep. 105-220, 105th Cong., 1st Sess. 382, 383 (1997). Thus, under these settled principles, gain on installment payments received after May 6, 1997, from sales on or before that date, is taxed at the new, lower maximum rates of 25 percent, 20 percent, or 10 percent if it qualifies as unrecaptured section 1250 gain or adjusted net capital gain. However, as in the case of gain from post-effective-date sales, section 1(h) does not specify how to allocate the two categories of gain.

The proposed regulations provide that the capital gain rates applicable to installment payments that are received on or after the effective date of the 1997 Act from sales prior to the effective date are determined as if, for all payments received after the date of sale but before the effective date, 25-percent gain had been taken into account before 20/10-percent gain. This approach is consistent with the Snell principle in that it provides for the same method of allocation, whether the sale occurred before or after the effective date of the 1997 Act. For taxpayers who sold property and received installment payments before the effective date of the 1997 Act, this provision is favorable, since it generally reduces or eliminates the amount of 25-percent gain to be reported on installment payments received after the effective date. The approach is also simple — because it is generally irrelevant how the prior gain was actually reported and taxed, in most cases taxpayers will simply calculate the total amount of 25-percent gain on the sale and subtract from that all gain previously reported, in order to arrive at the amount of 25-percent gain remaining to be reported.

*Treatment of Installment Payments Received Between the Effective Date of the Statute and the Effective Date of the Final Regulations.*

The proposed regulations also address the treatment of gain in installment payments that are received during the period between the effective date of section 1(h) and the effective date of the final regulations. The proposed regulations provide that, in the event the cumulative amount of 25-percent gain actually reported in installment payments received during this period was less than the amount that would have been reported using the front-loaded allocation method of the regulations, the amount of 25-percent gain actually reported, rather than an amount determined under a front-loaded allocation method, must be used in determining the amount of 25-percent gain that remains to be reported. This provision ensures that taxpayers cannot underreport the total amount of 25-percent gain by taking inconsistent positions with respect to payments received before and after the effective date of the regulations. By providing for this rule, no inference is in-

tended that any allocation method other than the method provided for by the regulations was a reasonable interpretation of section 1(h) in this context. However, the IRS will not challenge the use of a pro rata allocation method—that is, a method under which the amounts of 25-percent gain and 20/10-percent gain in each installment payment bear the same relationship as the total amounts of 25-percent and 20/10-percent gain to be reported on the sale—for installment payments received before the effective date of the final regulations, if the taxpayer used the same pro rata method for all installment payments during such period.

*Proposed Effective Date*

The regulations are proposed to be effective for payments properly taken into account after the date the regulations are published as final regulations in the *Federal Register*.

*Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a requirement for the collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

*Comments and Requests for a Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and

copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

*Drafting Information*

The principal authors of these regulations are Susan Kassell and Rob Laude-man, Office of the Assistant Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

*Proposed Amendment to the Regulations*

Accordingly, the IRS proposes to amend 26 CFR part 1 as follows:

**PART 1—INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.453-12 is added to read as follows:

*§1.453-12 Allocation of unrecaptured section 1250 gain reported on the installment method.*

(a) *General rule.* Unrecaptured section 1250 gain, as defined in section 1(h)(7), is reported on the installment method if that method otherwise applies under section 453 or 453A and the corresponding regulations. If gain from an installment sale includes unrecaptured section 1250 gain and adjusted net capital gain (as defined in section 1(h)(4)), the unrecaptured section 1250 gain is taken into account before the adjusted net capital gain.

(b) *Installment payments from sales before May 7, 1997.* The amount of unrecaptured section 1250 gain in an installment payment that is properly taken into account after May 6, 1997, from a sale before May 7, 1997, is determined as if, for all payments properly taken into account after the date of sale but before May 7, 1997, unrecaptured section 1250 gain had been taken into account before adjusted net capital gain.

(c) *Installment payments received after May 6, 1997, and before the effective date of the final regulations.* If the amount of

unrecaptured section 1250 gain in an installment payment that is properly taken into account after May 6, 1997, and before the effective date of the final regulations, is less than the amount that would have been taken into account under this section, the lesser amount is used to determine the amount of unrecaptured section 1250 gain that remains to be taken into account.

(d) *Examples.* In each example, the taxpayer, an individual whose taxable year is the calendar year, does not elect out of the installment method. The installment obligation bears adequate stated

interest, and the property sold is real property held in a trade or business that qualifies as both section 1231 property and section 1250 property. In all taxable years, the taxpayer's marginal tax rate on ordinary income is 28 percent. The following examples illustrate the rules of this section:

*Example 1. General rule.* This example illustrates the rule of paragraph (a) of this section.

(i) In 1998, A sells property for \$10,000, to be paid in ten equal annual installments beginning on December 1, 1998. A originally purchased the property for \$5,000, held the property for several years, and took straight-line depreciation deductions in the

amount of \$3,000. In each of the years 1998-2007, A has no other capital or section 1231 gains or losses.

(ii) A's adjusted basis at the time of the sale is \$2,000. Of A's \$8,000 of section 1231 gain on the sale of the property, \$3,000 is attributable to prior straight-line depreciation deductions and is unrecaptured section 1250 gain. The gain on each installment payment is \$800.

(iii) As illustrated in the following table, A takes into account the unrecaptured section 1250 gain first. Therefore, the gain on A's first three payments, received in 1998, 1999, and 2000, is taxed at 25 percent. Of the \$800 of gain on the fourth payment, received in 2001, \$600 is taxed at 25 percent and the remaining \$200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows:

	1998	1999	2000	2001	2002	2003-2007	Total gain
Installment gain	800	800	800	800	800	4000	8000
Taxed at 25%	800	800	800	600			3000
Taxed at 20%				200	800	4000	5000
Remaining to be taxed at 25%	2200	1400	600				

*Example 2. Installment payments from sales prior to May 7, 1997.* This example illustrates the rule of paragraph (b) of this section.

(i) The facts are the same as in *Example 1* except that A sold the property in 1994, received the first of the ten annual installment payments on December 1, 1994, and had no other capital or section 1231 gains or losses in the years 1994-2003.

(ii) As in *Example 1*, of A's \$8000 of gain on the

sale of the property, \$3000 was attributable to prior straight-line depreciation deductions and is unrecaptured section 1250 gain.

(iii) As illustrated in the following table, A's first three payments, in 1994, 1995, and 1996, were received before May 7, 1997, and taxed at 28 percent. Under the rule described in paragraph (b) of this section, A determines the allocation of unrecaptured section 1250 gain for each installment payment after

May 6, 1997, by taking unrecaptured section 1250 gain into account first, treating the general rule of paragraph (a) of this section as having applied since the time the property was sold, in 1994. Consequently, of the \$800 of gain on the fourth payment, received in 1997, \$600 is taxed at 25 percent and the remaining \$200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows:

	1994	1995	1996	1997	1998	1999-2003	Total gain
Installment gain	800	800	800	800	800	4000	8000
Taxed at 28%	800	800	800				2400
Taxed at 25%				600			600
Taxed at 20%				200	800	4000	5000
Remaining to be taxed at 25%	2200	1400	600				

*Example 3. Effect of section 1231(c) recapture.* This example illustrates the rule of paragraph (a) of this section when there are non-recaptured net section 1231 losses, as defined in section 1231(c)(2), from prior years.

(i) The facts are the same as in *Example 1*, except that in 1998 A has non-recaptured net section 1231 losses from the previous four years of \$1000.

(ii) As illustrated in the following table, in 1998, all of A's \$800 installment gain is recaptured as ordinary income under section 1231(c). Under the rule described in paragraph (a) of this section, for

purposes of determining the amount of unrecaptured section 1250 gain remaining to be taken into account, the \$800 recaptured as ordinary income under section 1231(c) is treated as reducing unrecaptured section 1250 gain, rather than adjusted net capital gain. Therefore, A has \$2200 of unrecaptured section 1250 gain remaining to be taken into account.

(iii) In 1999, A's installment gain is taxed at two rates. First, \$200 is recaptured as ordinary income under section 1231(c). Second, the remaining \$600 of gain on A's 1999 installment payment is taxed at

25 percent. Because the full \$800 of gain reduces unrecaptured section 1250 gain, A has \$1400 of unrecaptured section 1250 gain remaining to be taken into account.

(iv) The gain on A's installment payment received in 2000 is taxed at 25 percent. Of the \$800 of gain on the fourth payment, received in 2001, \$600 is taxed at 25 percent and the remaining \$200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows:

	1998	1999	2000	2001	2002	2003-2007	Total gain
Installment gain	800	800	800	800	800	4000	8000
Taxed at ordinary rates under section 1231(c)	800	200					1000
Taxed at 25%		600	800	600			2000
Taxed at 20%				200	800	4000	5000
Remaining non-recaptured net section 1231 losses	200						
Remaining to be taxed at 25%	2200	1400	600				

*Example 4. Effect of a net section 1231 loss.* This example illustrates the application of paragraph (a) of this section when there is a net section 1231 loss.

(i) The facts are the same as in *Example 1* except that A has section 1231 losses of \$1000 in 1998.

(ii) In 1998, A's section 1231 installment gain of \$800 does not exceed A's section 1231 losses of \$1000. Therefore, A has a net section 1231 loss of \$200. As a result, under section 1231(a) all of A's section 1231 gains and losses are treated as ordinary gains and losses. As illustrated in the following table, A's entire \$800 of installment gain is ordinary gain. Under the rule described in paragraph (a) of

this section, for purposes of determining the amount of unrecaptured section 1250 gain remaining to be taken into account, A's \$800 of ordinary section 1231 installment gain in 1998 is treated as reducing unrecaptured section 1250 gain. Therefore, A has \$2200 of unrecaptured section 1250 gain remaining to be taken into account.

(iii) In 1999, A has \$800 of section 1231 installment gain, resulting in a net section 1231 gain of \$800. A also has \$200 of non-recaptured net section 1231 losses. The \$800 gain is taxed at two rates. First, \$200 is taxed at ordinary rates under section 1231(c), recapturing the \$200 net section 1231 loss sustained in 1998. Second, the remaining \$600 of

gain on A's 1999 installment payment is taxed at 25 percent. As in *Example 3*, the \$200 of section 1231(c) gain is treated as reducing unrecaptured section 1250 gain, rather than adjusted net capital gain. Therefore, A has \$1400 of unrecaptured section 1250 gain remaining to be taken into account.

(iv) The gain on A's installment payment received in 2000 is taxed at 25 percent, reducing the remaining unrecaptured section 1250 gain to \$600. Of the \$800 of gain on the fourth payment, received in 2001, \$600 is taxed at 25 percent and the remaining \$200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows:

	1998	1999	2000	2001	2002	2003-2007	Total gain
Installment gain	800	800	800	800	800	4000	8000
Ordinary gain under section 1231(a)	800						800
Taxed at ordinary rates under section 1231(c)		200					200
Taxed at 25%		600	800	600			2000
Taxed at 20%				200	800	4000	5000
Net section 1231 loss	200						
Remaining to be taxed at 25%	2200	1400	600				

(e) *Effective date.* This section applies to installment payments properly taken into account after the date these regulations are published as final regulations in the **Federal Register**.

Robert E. Wenzel,  
Deputy Commissioner of  
Internal Revenue.

(Filed by the Office of the Federal Register on January 21, 1999, 8:45 a.m., and published in the issue of the Federal Register for January 22, 1999, 64 F.R. 3457)

## Notice of Proposed Rulemaking Passive Foreign Investment Companies; Definition of Marketable Stock

**REG-113744-98**

AGENCY: Internal Revenue Service  
(IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the new

mark to market election for stock of a passive foreign investment company (PFIC). The proposed regulations interpret changes made by the Taxpayer Relief Act of 1997. The proposed regulations affect persons holding PFIC stock that is regularly traded on certain U.S. or foreign exchanges or markets or holding stock in certain PFICs comparable to U.S. regulated investment companies (RICs). The proposed regulations also reserve treatment of and request comments on making the mark to market election for options on marketable stock.



**DATES:** Written comments or requests for a public hearing must be received by May 3, 1999.

**ADDRESSES:** Send submissions to CC:DOM:CORP:R (REG-113744-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-110524-98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at: [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html).

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Robert Laudeman, (202) 622-3840; concerning submissions, LaNita VanDyke, (202) 622-7190 (not toll-free numbers).

#### **SUPPLEMENTARY INFORMATION:**

##### *Background*

This notice contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) regarding the taxation of U.S. holders of PFIC stock.

Since the enactment of the Tax Reform Act of 1986, U.S. holders of PFIC stock have been subject to two alternative sets of inclusion rules: the interest charge rules under section 1291 of the Internal Revenue Code and the qualified electing fund (QEF) rules under section 1293.

The interest charge rules apply to shareholders of PFICs that are not QEFs or for which a QEF election is unavailable. Under the interest charge rules, the PFIC shareholders pay tax and an interest charge that is attributable to the value of deferral on receipt of certain distributions and on disposition of the PFIC stock. By contrast, PFIC shareholders who make a QEF election include currently in gross income their respective shares of the PFIC's total earnings, with a separate election to defer payment of tax, subject to an interest charge, on income not currently received.

Congress recognized that the interest charge rules are a substantial source of complexity for PFIC shareholders and that some shareholders would prefer the current inclusion method afforded by the QEF election, but are unable to make the election because they cannot obtain the necessary information from the PFIC. Congress accordingly enacted new section 1296 in the Tax Reform Act of 1997 to provide PFIC shareholders with an alternative method to include income currently with respect to their interests in a PFIC by allowing PFIC shareholders to elect to mark to market PFIC stock that qualifies as marketable stock.

In general, a PFIC shareholder who elects under section 1296 to mark to market the marketable stock of a PFIC includes in income each year an amount equal to the excess, if any, of the fair market value of the PFIC stock as of the close of the taxable year over the shareholder's adjusted basis in such stock. A shareholder is also generally allowed a deduction for the excess, if any, of the adjusted basis of the PFIC stock over the fair market value as of the close of the taxable year. Deductions under this rule, however, are allowable only to the extent of any net mark to market gains with respect to the stock included by the shareholder for prior taxable years.

Section 1296(e)(1) defines *marketable stock* as including several categories of stock. First, section 1296(e)(1)(A) states that marketable stock includes any stock which is regularly traded on (i) a national securities exchange which is registered with the Securities and Exchange Commission (SEC) or the national market system established pursuant to section 11A of the Securities Exchange Act of 1934, or (ii) any exchange or other market which the Secretary determines has rules adequate to carry out the purposes of the PFIC provisions. With respect to (ii) above, the conference report specifies that "PFIC stock is considered marketable if it is regularly traded on any exchange or market that the Secretary of the Treasury determines has rules sufficient to ensure that the market price represents a legitimate and sound fair market value." H.R. Conf. Rep. No. 2014, 105th Cong., 1st Sess. 625 (1997). Second, section 1296(e)(1)(B) states that, to the extent provided in regulations, stock in any for-

eign corporation which is comparable to a RIC and which offers for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value will be marketable stock. Third, section 1296(e)(1)(C) states that, to the extent provided in regulations, any option on stock described in section 1296(e)-(1)(A) or (B) will constitute marketable stock.

Section 1296(e)(2) provides that in the case of any RIC which is offering for sale or has outstanding any stock of which it is the issuer and which is redeemable at net asset value, all stock in a PFIC which it owns directly or indirectly shall be treated as marketable stock for purposes of section 1296. Section 1296(e)(2) further provides that except as provided in regulations, similar treatment as marketable stock shall apply in the case of any other RIC which publishes net asset valuations at least annually.

The proposed regulations define marketable stock for purposes of section 1296. Specifically, the proposed regulations define regularly traded and list attributes that a foreign exchange or market must have in order for PFIC stock traded on such an exchange or market to be eligible for the mark to market election. The definition of regularly traded and the attributes required of foreign exchanges or markets are intended to ensure that the prices of PFIC shares listed on the exchange or market represent legitimate and sound fair market values. The proposed regulations also list the attributes that a foreign corporation must satisfy to be comparable to a RIC, and thus for its stock to be marketable stock. The attributes are intended to ensure that the foreign corporation is an investment vehicle similar in relevant respects to a U.S. mutual fund and that its representations of net asset value represent a legitimate fair market value.

##### *Explanation of Provisions*

###### *Regularly Traded*

Under the proposed regulations, the class of PFIC stock held by the shareholder must be traded, other than in *de minimis* quantities, on at least 15 days during each calendar quarter. The proposed regulations also include an anti-abuse rule to prevent persons from manip-

ulating the number of trades in order to meet this test.

#### *Exchange or Other Market*

The proposed regulations require that a foreign exchange or market be regulated or supervised by a governmental authority of the country in which the market is located. This requirement will help to ensure that the prices of the stock listed by the exchange are legitimate and sound fair market values. Because the degree of governmental regulation or supervision for each foreign exchange or market may vary by exchange or market or country, the proposed regulations also list additional characteristics that the foreign exchange or market must have for stock that is regularly traded on the exchange or market to be considered marketable stock for purposes of section 1296.

First, the exchange must have trading volume, listing, financial disclosure and other requirements, designed to prevent fraud, perfect the mechanism of a free and open market, and protect investors. See section 6 of the Securities Exchange Act of 1934, 15 U.S.C. 78f. There must be actual enforcement of these requirements by the exchange and government of the country in which the exchange is located.

Second, the rules of the exchange must ensure active trading of listed stocks.

Finally, the IRS and Treasury Department invite comments on whether PFIC stock that is regularly traded on any other type of exchange or market, such as an over-the-counter market, should be considered marketable stock. Additional comments are requested about what features those exchanges or markets should have to ensure that the stock prices quoted on such markets are legitimate and sound fair market values.

#### *Stock in Certain PFICs*

The proposed regulations provide that stock in certain PFICs will be *marketable stock* if the PFIC is a corporation described in section 1296(e)(1)(B) (foreign corporations comparable to RICs) and if the PFIC offers for sale or has outstanding stock of which it is the issuer and which is redeemable at its net asset value. A PFIC will be a corporation described in section 1296(e)(1)(B) if the PFIC satisfies the conditions listed in the proposed regula-

tions and described below, with respect to the class of shares held by the electing taxpayer. These conditions are intended to describe PFICs that are comparable to U.S. RICs in relevant respects and to implement the intent of the statute by ensuring that the net asset valuations of such companies represent legitimate and sound fair market values for the companies' stock.

First, the class of stock held by an electing shareholder must be held by one hundred or more unrelated shareholders. The relationships set forth in section 267(b) are used to define related shareholders that are excluded from satisfying this test. This condition is consistent with the requirements for RICs under section 851(a) and §1.851-1 of the income tax regulations.

Second, the applicable class of shares of the foreign corporation must be regularly available for purchase by the general public at its net asset value in initial amounts not greater than \$10,000 (U.S.). The IRS and Treasury Department invite comments on whether \$10,000 is the appropriate ceiling to ensure that the shares of the company will be widely available to the general public. The IRS and Treasury Department also invite comments on whether and under what conditions the regulations should allow shares of a foreign corporation to be purchased at amounts different from their net asset value, such as for a price that includes a sales load. Additional comments are requested about whether the regulations should cover foreign corporations that otherwise qualify but are closed to new investors.

Third, the proposed regulations require that quotations for the class of shares of the foreign corporation be determined and published on a daily basis in a widely-available medium, such as a newspaper of general circulation. This requirement approximates the practice of U.S. RICs and is intended to ensure that shareholders and prospective purchasers have regular access to publicly available price information.

Fourth, financial statements of the foreign corporation prepared by independent auditors that include balance sheets (statements of assets, liabilities, and net assets) and statements of income and expenses, must be prepared and made available to the public no less frequently than annu-

ally. This requirement approximates the requirements imposed on U.S. mutual funds by the SEC and is intended to ensure that shareholders and prospective purchasers have regular access to financial information for the foreign corporation.

Fifth, the foreign corporation must be supervised or regulated as an investment company by a foreign government or an agency or instrumentality thereof. This condition is intended to approximate the SEC's regulation of U.S. RICs while taking into account the variety of regulatory regimes used by different governments.

Sixth, the foreign corporation may not have any senior securities authorized or outstanding, including any debt other than *de minimis* amounts. This requirement is similar to the requirement imposed on U.S. RICs by the SEC.

Finally, the foreign corporation must meet the PFIC income and asset tests in sections 1297(a)(1) and (2) with the requisite percentages increased from 75 percent to 90 percent and from 50 percent to 90 percent respectively. This condition is intended to approximate the characteristic of U.S. RICs as passive investment vehicles.

The proposed regulations also include an anti-abuse rule to prevent a foreign corporation from improperly manipulating its net asset valuations to reduce the U.S. tax under section 1296 of one or more shareholders of the corporation.

#### *Options on Marketable Stock*

The proposed regulations reserve the paragraph for defining how and when options on marketable stock, as defined by these regulations, will be eligible for mark to market treatment. The IRS and Treasury Department invite comments regarding the conditions under which the regulations should define options on marketable stock to be marketable stock.

#### *Special Rules for RICs*

The proposed regulations clarify that shares in a PFIC that are owned directly or indirectly by a U.S. RIC, which is offering for sale or has outstanding any stock of which it is the issuer and which is redeemable at net asset value, shall be treated as marketable stock for purposes of section 1296. The IRS and Treasury Department invite comments regarding situations where PFIC stock held by other U.S.

RICs that publish asset valuations at least annually should not be treated as marketable stock for purposes of section 1296.

#### *Proposed Effective Date*

The regulations are proposed to be applicable for shareholders whose taxable years end on or after the date these regulations are published as final regulations in the **Federal Register**. In addition, it is proposed that shareholders may elect to apply these regulations to taxable years beginning after December 31, 1997.

#### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a requirement for the collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### *Comments and Requests for a Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

#### *Drafting Information*

The principal author of these regulations is Robert Laudeman, Office of the

Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

#### *Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.1296(e)–1 also issued under 26 U.S.C. 1296(e). \* \* \*

Par. 2. Section 1.1296(e)–1 is added to read as follows:

#### *§1.1296(e)–1 Definition of marketable stock.*

(a) *General rule.* For purposes of section 1296, the term *marketable stock* means—

(1) Passive foreign investment company (PFIC) stock that is regularly traded, as defined in paragraph (b) of this section, on a qualified exchange or other market, as defined in paragraph (c) of this section;

(2) Stock in certain PFICs, as described in paragraph (d) of this section; and

(3) Options on stock that is described in paragraph (a)(1) or (2) of this section, to the extent provided in paragraph (e) of this section.

(b) *Regularly traded*—(1) *General rule.* For purposes of paragraph (a)(1) of this section, a class of stock that is traded on one or more qualified exchanges or other markets, as defined in paragraph (c) of this section, is considered to be regularly traded on such exchanges or markets for any calendar year during which such class of stock is traded, other than in *de minimis* quantities, on at least 15 days during each calendar quarter.

(2) *Anti-abuse rule.* Trades that have as one of their principal purposes the meeting of the trading requirement of paragraph (b)(1) of this section shall be disregarded. Further, a class of stock shall not be treated as meeting the trading requirement of paragraph (b)(1) of this section if there is a pattern of trades con-

ducted to meet the requirement of paragraph (b)(1) of this section.

(c) *Qualified exchange or other market*—(1) *General rule.* For purposes of paragraph (a)(1) of this section, the term *qualified exchange or other market* means, for any taxable year—

(i) A national securities exchange which is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(ii) A foreign securities exchange that is regulated or supervised by a governmental authority of the country in which the market is located and which has the following characteristics—

(A) The exchange has trading volume, listing, financial disclosure, and other requirements designed to prevent fraudulent and manipulative acts and practices, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors; and the laws of the country in which the exchange is located and the rules of the exchange ensure that such requirements are actually enforced; and

(B) The rules of the exchange ensure active trading of listed stocks.

(2) *Exchange with multiple tiers.* If an exchange in a foreign country has more than one tier or market level on which stock may be separately listed or traded, each such tier shall be treated as a separate exchange.

(d) *Stock in certain PFICs*—(1) *General rule.* Except as provided in paragraph (d)(2) of this section, a foreign corporation will be a corporation described in section 1296(e)(1)(B), and paragraph (a)(2) of this section, if the foreign corporation offers for sale or has outstanding stock of which it is the issuer and which is redeemable at its net asset value and if the foreign corporation satisfies the following conditions with respect to the class of shares held by the electing taxpayer—

(i) The foreign corporation has one hundred or more shareholders with respect to the class, other than shareholders who are related under section 267(b);

(ii) The class of shares of the foreign corporation is readily available for purchase by the general public at its net asset



value by new investors in initial amounts not greater than \$10,000 (U.S.);

(iii) Quotations for the class of shares of the foreign corporation are determined and published on a daily basis in a widely-available medium, such as a newspaper of general circulation;

(iv) No less frequently than annually, independent auditors must prepare financial statements of the foreign corporation that include balance sheets (statements of assets, liabilities, and net assets) and statements of income and expenses, and those statements must be made available to the public;

(v) The foreign corporation is supervised or regulated as an investment company by a foreign government or an agency or instrumentality thereof;

(vi) The foreign corporation has no senior securities authorized or outstanding, including any debt other than in *de minimis* amounts;

(vii) Ninety percent or more of the gross income of the foreign corporation for its taxable year is passive income, as defined in section 1297(a)(1) and the regulations thereunder; and

(viii) The average percentage of assets held by the foreign corporation during its taxable year which produce passive income or which are held for the production of passive income, as defined in section 1297(a)(2) and the regulations thereunder, is at least 90 percent.

(2) *Anti-abuse rule.* If a foreign corporation undertakes any action with a principal purpose of manipulating the net asset value of a class of its shares in order to reduce the United States tax under section 1296 of one or more of its shareholders, the class of shares will not qualify as marketable stock for purposes of paragraph (d)(1) of this section.

(e) [Reserved]

(f) *Special rules for regulated investment companies (RICs)*—(1) *General rule.* In the case of any RIC which is offering for sale or has outstanding any stock of which it is the issuer and which is redeemable at net asset value, its stock in any passive foreign investment company which it owns directly or indirectly, as defined in sections 958(a)(1) and (2), shall be treated as marketable stock owned by that RIC for purposes of section 1296.

(2) [Reserved]

(g) *Effective date.* This section applies

to shareholders whose taxable year ends on or after the date these regulations are published as final regulations in the **Federal Register** for stock in a foreign corporation whose taxable year ends with or within the shareholder's taxable year. In addition, shareholders may elect to apply these regulations to any taxable year beginning after December 31, 1997, for stock in a foreign corporation whose taxable year ends with or within the shareholder's taxable year.

Robert E. Wenzel,  
*Deputy Commissioner of  
Internal Revenue.*

(Filed by the Office of the Federal Register on February 1, 1999, 8:45 a.m., and published in the issue of the Federal Register for February 2, 1999, 64 F.R. 5012)

## Foundations Status of Certain Organizations

### Announcement 99-19

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

*Former Public Charities.* The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Financial Assistance counseling and Training Services, St. Paul, MN  
Finger Lakes youth Sports Inc., Geneva, NY  
Fire Safety Education Inc., Plymouth, MI  
Fire Safety Education Task Force, Cleveland, OH  
Firm Foundation Ministries, Lincoln Park, MI  
First Coast Business Investment Corporation, Jacksonville, FL

First Coast Crisis Pregnancy Center, Jacksonville, FL  
First Freedom Coalition Educational Fund, Washington, DC  
First International Fellowship, Philadelphia, PA  
First Light Dance Theatre, Knoxville, TN  
First Step Crisis Pregnancy Center Inc., Smithfield, NC  
First Step I Inc., Knoxville, TN  
First Step II Inc., Knoxville, TN  
First Step Inc. of the Fifth Judicial Circuit, Tavares, FL  
Fish Forever, Seattle, WA  
Fitspatrick Tennis Association Inc., New York, NY  
Flagler County Historical Society Inc., Bunnell, FL  
Flatbush Youth Inc., Brooklyn, NY  
Flemister Housing Development Fund Corporation, New York, NY  
Flickinger Center Foundation Inc., Alamogordo, NM  
Flood Care Inc., Ursa, IL  
Floral EMS, Floral, AL  
Florence Griffith Joyner Youth Foundation, Mission Viejo, CA  
Florida Bio Diversity Project Inc., Fort Lauderdale, FL  
Florida Classic Association Inc., Tampa, FL  
Florida Community Learning and Information Network Inc., Fort Lauderdale, FL  
Florida Foundation for the Preservation of Sight Inc., Zephyrhills, FL  
Florida Youth Foundation Inc., Plant City, FL  
Floyd Wickman Courses Family to Family Inc., Troy, MI  
Food for the Mind Inc., Miller Place, NY  
Footprints, Tacoma, WA  
For His Glory Ministries, Inc., Virginia Beach, VA  
For Petes Sake Productions, Upper Marlboro, MD  
For the Lord, Federal Way, WA  
For the People Inc., Brooklyn, NY  
Foreign Student Education Foundation Inc., Charlotte, NC  
Forensic Artists International, Towson, MD  
Forest Hills Parent Network Inc., Grand Rapids, MI  
Fort Collins Community Computer Network, Fort Collins, CO



Fort Phil Kearny-Bozeman Trail  
Endowment Foundation Inc., Buffalo,  
WY

Fort Smith Volunteer Connection Inc.,  
Fort Smith, AR

Fort Worth Area Convention Committee,  
Fort Worth, TX

Fort Worth Citizen Police Academy  
Association, Fort Worth, TX

Forty Five North Kingston Avenue Inc.,  
Cranford, NJ

Foundation De Manana Inc., Riverdale,  
GA

Foundation for Agency Management  
Excellence Inc., Washington, DC

Foundation for Aid to Needy Children in  
Berkshire County, Stockbridge, MA

Foundation for Educational Innovation  
Inc., Washington, DC

Foundation for Equine Facilitated  
Psychotherapy, Englewood, CO

Foundation for Excellence in Arts  
Education, Tucson, AZ

Foundation for Headache and Neuro-  
Rehabilitation, Denver, CO

Foundation for Hospice of Rowan  
County Inc., Salisbury, NC

Foundation for International  
Development Alternative Inc., Long  
Island City, NY

Foundation for International Cancer  
Control Studies Inc., Madison, WI

Foundation for Mens Health, Dallas,  
TX

Foundation for Religion and the Arts,  
New Haven, CT

Foundation for Reproductive Health,  
Birmingham, AL

Foundation for Sustainable Development,  
Washington, DC

Foundation for Tax Education Inc.,  
Boston, MA

Foundation for the Advancement of Arts  
and Sciences from India Inc., Flushing,  
NY

Foundation for the Benefit of Disabled  
Persons, New York, NY

Foundation for the Children of Panama  
Inc., New York, NY

Foundation for the Collegiate, New  
Rochelle, NY

Foundation of the Interreligious Council  
of Central New York Inc., Syracuse,  
NY

Foundation to Eliminate E Coli  
Outbreaks, Gig Harbor, WA

Foundation to Eliminate the National  
Debt Inc., Madison, WI

Fountain Hills Schools Partnership  
Foundation, Fountain Hills, AZ

Four Square Hospice Inc., Madill, OK

Foxs Den Goodwill Club Incorporated,  
Baltimore, MD

Frameworks Education Project,  
Minneapolis, MN

Fran Crosby Memorial Fund Inc.,  
Leonardo, NJ

Frankford Senior Housing Associates,  
Philadelphia, PA

Franklin County Citizens for Historic  
Preservation, Cedar Grove, IN

Franklin Lakes Youth & Recreation  
Foundation Inc., Franklin Lakes, NJ

Fred N Stones Jr Memorial Scholarship  
Fund, Waxahachie, TX

Free Africa Foundation Inc., Washington,  
DC

Free Clinic for Substance Abuse Inc.,  
Richmond, VA

Free Spirit Ranch Inc., Plains, GA

Freedom Adventures Inc., Jacksonville,  
FL

Freedom in Motion Inc., Princeton, WV

Freedom League Inc., Miami, FL

Freedom Today Not Tomorrow Inc.,  
Olathe, KS

French Heritage Relief Committee-  
Operation Mississippi, Chicago, IL

Friends and Former Students of Bolling  
School Inc., Lewisburg, WV

Friends and Neighbors Ltd., Denver, CO

Friends for Conservation of the San  
Antonio River Basin, Goliad, TX

Friends of Africa Inc., Los Angeles, CA

Friends of Ams Green Tree Health Center  
Inc., Glendale, WI

Friends of Anzar Hills, Aromas, CA

Friends of British Virgin Island National  
Parks USA Inc., British Virgin Islands

Friends of CASA Association, Newark,  
DE

Friends of CMH Sumner Community  
Memorial Hospital Foundation,  
Sumner, IA

Friends of Companion Animals Inc.,  
Lathrop, MO

Friends of Confide Inc., Rockville Centre,  
NY

Friends of Crossroads Center, Bellevue,  
WA

Friends of E M U Ltd., Ypsilanti, MI

Friends of Feral Felines Inc., Atascadero,  
CA

Friends of Greenfield Recreation Inc.,  
Greenfield, MA

Friends of ICA Moscow Inc., New York,  
NY

Friends of Italian Culture Amici Dei Beni  
Culturali Inc., New York, NY

Friends of Kidtown Playground,  
Brookings, OR

Friends of Leverett Pond Inc., Amherst,  
MA

Friends of Lynn & Nahant Beach, Lynn,  
MA

Friends of Maitland Middle School Inc.,  
Maitland, FL

Friends of Monona Inc., Monona, WI

Friends of Refugees of Eastern Europe  
Inc., W. Bloomfield, MI

Friends of Rodeo Inc., Chowchilla, CA

Friends of Rosevilles Harriet Alexander  
Nature Center Inc., Minneapolis, MN

Friends of Roxaboxen, Yuma, AZ

Friends of Russell Latimer Inc.,  
San Diego, CA

Friends of Santa Inc., Chicago, IL

Friends of Shaarei Mevasseret Inc.,  
Monsey, NY

Friends of Staraya Russia, Canandaigua,  
NY

Friends of the Bowerston Public Library  
Inc., Bowerston, OH

Friends of the Business Resource Center,  
Glen Allen, VA

Friends of the Dr Eugene Clark Library  
Lockhart TX, Lockhart, TX

Friends of the Golan Settlements  
Committee Inc., Brooklyn, NY

Friends of the International School of Art  
Inc., Brooklyn, NY

Friends of the Limestone Country Trail  
Inc., Bloomington, IN

Friends of the Mary M Campbell Library  
Inc., Marcus Hook, PA

Friends of the Mississippi River, St. Paul,  
MN

Friends of the Norton-Dare House Inc.,  
Selden, NY

Friends of the Old Synagogue in The  
Hague Holland, Stamford, CT

Friends of the Raanana Symphonette  
Orchestra Inc., New York, NY

Friends of the Seige & Battle of Corinth  
Inc., Corinth, MS

Friends of the University of the Holly  
Spirit of Kaslik Inc., Miami, FL

Friends of the Wicomico County Free  
Library Inc., Salisbury, MD

Friends of the Youth Study Center Inc.,  
Philadelphia, PA

Friends of Tikvatenu Youth Centers,  
Dallas, TX

Friends of Tiverton Library Services Inc.,  
Tiverton, RI

Friends of Van Voorhees Park Inc.,  
 Brooklyn, NY  
 Friends of Washington Adventist Hospital  
 Inc., Potomac, MD  
 Friends of Women and Children, Chicago,  
 IL  
 Friendship Foundation of American-  
 Vietnamese Inc., Lorain, OH  
 Friendship Home of Wells Inc., Wells, MN  
 Friendship Hospice Memorial Foundation  
 Inc., Nashville, TN  
 Friendship House of India, Warren, MI  
 Friendship Project Corporation, Larkspur,  
 CA  
 Frost Parent Teacher Organization, Mesa,  
 AZ  
 Fund for Labor Education Inc., New York,  
 NY  
 Fundacion Pro-Desarrollo De Barahona  
 Inc., Bronx, NY  
 Future Generations Inc., Little Rock, AR  
 Future Problem Solving Program of  
 Alabama Inc., Homewood, AL  
 Fuente De Agua Viva, Arlington, VA  
 Full Moon Theatre Inc., Providence, RI

Fulton Church & Community Workers  
 Inc., Fulton, NY  
 Genesis II Hamilton Heights Development  
 Corporation, New York, NY  
 Grace Mining Company, Fountain Valley,  
 CA  
 Graceland Ministries, Inc., Benton, KY  
 Ground Zero, Colorado Springs, CO  
 Group for Research and Aid to Abductees,  
 Cary, NC  
 Growth Adventures Inc., Houston, TX  
 Guadalupe Foundation Inc., Evanston, IL  
 Guardian Care of Madison Inc., Portage,  
 WI  
 Guardian Society, Villa Park, CA  
 Guatemala Information Documentation  
 and Education Center Inc., Arlington,  
 VA  
 Guatemaltecos Unidos en Accion of  
 Rhode Island Inc., Cranston, RI  
 Gulfcoast C A D R E Inc., Bradenton, FL  
 Gunnison Basin Community Forum,  
 Crested Butte, CO  
 Gymnastics Oregon, Ashland, OR  
 Hancock Family Foundation, Inc.,  
 Annapolis, MD

Hickory Nut Gorge Wilderness, Lake  
 Lure, NC  
 Interdisciplinary Council on  
 Developmental & Learning Disorders,  
 Inc., Bethesda, MD  
 Interpower Group, Inc., Detroit, MI  
 Nutritional Research and Educational  
 Foundation Inc., New York, NY  
 Project Turnabout, Claremont, CA  
 Scranton Lockawanna Resource  
 Development Corp., Scranton, PA  
 If an organization listed above submits  
 information that warrants the renewal of  
 its classification as a public charity or as a  
 private operating foundation, the Internal  
 Revenue Service will issue a ruling or de-  
 termination letter with the revised classi-  
 fication as to foundation status. Grantors  
 and contributors may thereafter rely upon  
 such ruling or determination letter as pro-  
 vided in section 1.509(a)-7 of the Income  
 Tax Regulations. It is not the practice of  
 the Service to announce such revised clas-  
 sification of foundation status in the Inter-  
 nal Revenue Bulletin.

## Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it ap-

plies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

## Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

A—Individual.  
Acq.—Acquiescence.  
B—Individual.  
BE—Beneficiary.  
BK—Bank.  
B.T.A.—Board of Tax Appeals.  
C.—Individual.  
C.B.—Cumulative Bulletin.  
CFR—Code of Federal Regulations.  
CI—City.  
COOP—Cooperative.  
Ct.D.—Court Decision.  
CY—County.  
D—Decedent.  
DC—Dummy Corporation.  
DE—Donee.  
Del. Order—Delegation Order.  
DISC—Domestic International Sales Corporation.  
DR—Donor.  
E—Estate.  
EE—Employee.

E.O.—Executive Order.  
ER—Employer.  
ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contribution Act.  
FISC—Foreign International Sales Company.  
FPH—Foreign Personal Holding Company.  
F.R.—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign Corporation.  
G.C.M.—Chief Counsel's Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.  
P—Parent Corporation.

PHC—Personal Holding Company.  
PO—Possession of the U.S.  
PR—Partner.  
PRS—Partnership.  
PTE—Prohibited Transaction Exemption.  
Pub. L.—Public Law.  
REIT—Real Estate Investment Trust.  
Rev. Proc.—Revenue Procedure.  
Rev. Rul.—Revenue Ruling.  
S—Subsidiary.  
S.P.R.—Statements of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.  
Z—Corporation.

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<sup>1</sup> A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1998–1 through 1998–52 will be found in Internal Revenue Bulletin 1999–1, dated January 4, 1999.



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